Chapter Four

Entitlements and Other Mandatory Spending

Entitlement programs provide benefits to all who are eligible to receive aid and choose to participate. Social Security, Medicare, Medicaid, food stamps, and farm price supports are major federal entitlements. Spending on those and other so-called mandatory programs accounts for more than one-half of all federal outlays. In 1997, this category is expected to cost $916 billion--about 12 percent of gross domestic product (GDP).

Under current law, outlays for mandatory programs are expected to increase at an average annual rate of 6.2 percent between 1997 and 2002. Under the Congressional Budget Office's (CBO's) baseline with discretionary spending adjusted for inflation after 1998, the rest of federal spending is projected to rise by an average of 2.5 percent a year during the same period. If current policies continue, entitlements could constitute nearly two-thirds of all federal spending by early in the next century. The aging of the baby-boom generation is expected to drive the fraction still higher over succeeding decades. Hence, the job of managing the growth of federal spending will be largely a matter of controlling the growth of mandatory outlays.

Spending on entitlement programs is primarily determined by the programs' rules that govern eligibility, the extent of participation, benefit levels, and the cost of providing noncash benefits, not by the annual appropriation process. A variety of other factors also increase or decrease outlays for entitlements, including demographic shifts, changes in providers' practices, and rates of inflation. Annual entitlement spending is, therefore, only partly under the direct control of the Congress.

The total that is spent on entitlements has grown rapidly since the early 1960s. As a share of GDP, however, much of the increase had already occurred by about 1975. Steadily increasing spending for retirement and disability programs, plus the creation of Medicare and Medicaid in 1965, spurred the growth of federal entitlement outlays from less than 6 percent of GDP in the early 1960s to about 11 percent in 1975. Since then, the share of national production committed to entitlement programs has grown more slowly and is expected to be about 13 percent by 2002.

Factors Underlying the Growth in Mandatory Spending

The largest force behind the continued growth in entitlement spending is the rapid rise in spending on Medicare and Medicaid. Although growth in the two programs has slowed in the past year, federal spending on them is expected to increase at an annual rate of about 8.3 percent between 1997 and 2002 if policies are not changed. By contrast, spending on other entitlements is expected to grow at an annual rate of about 5.1 percent during the 1997-2002 period without any changes in those programs. One convenient way of analyzing

growth in entitlement spending is to break it down by its major causes: growth in caseloads, automatic increases in benefits, growing use of medical services, and other factors.

Mounting caseloads account for only about one-fifth of the growth in entitlement programs. Compared with this year's outlays, spending will increase as a result of higher caseloads by $7 billion in 1998 and $57 billion in 2002 (see Table 4-1). The majority of that growth is concentrated in the Social Security and Medicare programs and is traceable to continued growth in the population of elderly and disabled people. Much of the rest is in Medicaid. Among those three programs, growth in caseloads alone boosts outlays by at least 14 percent apiece during the 1998-2002 period.

Automatic increases in benefits account for more than one-third of the growth in entitlement programs. All of the major retirement programs grant automatic cost-of-living adjustments (COLAs) to their beneficiaries. Those adjustments, which are pegged to the consumer price index, are expected to average about 3 percent a year through 2002. In 1997, outlays for programs with COLAs are nearing $500 billion, and COLAs are expected to add an extra $10 billion in 1998 and $74 billion in 2002.

Several other programs--chiefly the earned income tax credit (EITC), Food Stamps, and Medicare--are also automatically indexed to changes in prices. The income thresholds above which the EITC begins to be phased out are automatically adjusted for inflation using the

Table 4-1.
Sources of Growth in Mandatory Spending (By fiscal year, in billions of dollars)

	1998	1999	2000	2001	2002
Estimated Spending for Base Year 1997	916	916	916	916	916
Sources of Growth					
Increases in caseload	7	19	32	44	57
Automatic increases in benefits					
Cost-of-living adjustments	10	25	41	57	74
Other[a]	9	18	26	35	43
Other increases in benefits					
Increases in Medicare and Medicaid[b]	16	34	54	74	98
Growth in Social Security[c]	5	8	11	15	21
Irregular number of benefit payments[d]	0	0	8	-8	0
Change in outlays for deposit insurance	7	9	10	11	11
Remaining sources of growth	6	8	11	17	20
Total	60	121	194	245	324
Projected Spending	976	1,037	1,110	1,161	1,239

SOURCE: Congressional Budget Office.

a. Automatic increases in Food Stamp and child nutrition benefits, certain Medicare reimbursement rates, and the earned income credit under formulas specified by law.

b. All growth not attributed to caseloads and automatic increases in reimbursement rates.

c. All growth not attributed to caseloads and cost-of-living adjustments.

d. Represents baseline differences attributable to assumptions about the number of benefit checks that will be issued in a fiscal year. Supplemental Security Income, veterans' benefits, and Medicare payments to health maintenance organizations will pay 13 months of benefits in 2000, 11 months in 2001, and 12 in other years.

consumer price index. The Food Stamp program makes annual adjustments in its benefit payments according to changes in the Department of Agriculture's Thrifty Food Plan index. Medicare's payments to providers are based in part on special price indexes for the medical sector. The combined effect of indexing for these programs contributes an extra $9 billion in outlays in 1998 and $43 billion in 2002.

Medicaid is the only major entitlement program that is not automatically indexed for inflation at the federal level. Medicaid payments to providers are determined by the states and the federal government matches them. If states increase payments, federal payments will rise. (Higher payments to states are treated as "other" increases in Table 4-1.)

Another 45 percent of the growth in entitlement spending stems from increases that cannot be attributed to growth in caseloads or automatic adjustments in reimbursements. Those sources of growth are expected to become even more important over time. First, Medicaid spending grows with inflation even though it is not formally indexed (as discussed above). Second, the health programs have faced steadily rising costs per participant; that trend, which is often termed an increase in "intensity," reflects the consumption of more services per participant and the increasing use of more costly procedures. The residual growth in Medicare and Medicaid will amount to $16 billion in 1998 and $98 billion in 2002.

In most retirement programs, the average benefit grows faster than the COLA alone would explain. Social Security is a prime example. Because new retirees have more recent earnings that have been bolstered by real wage growth, their benefits generally exceed the monthly check of a long-time retiree who last earned a salary a decade or two ago and who has been receiving only cost-of-living adjustments since then. And because more women are working, more new retirees receive benefits based on their own earnings rather than a smaller, spouse's benefit. In Social Security alone, such phenomena are estimated to add $5 billion in 1998 and $21 billion in 2002.

Most of the remaining growth in benefit programs stems from rising benefits for new retirees in the civil service, military, and Railroad Retirement programs (fundamentally the same phenomenon as in Social Security); larger average benefits in unemployment compensation, a program that lacks an explicit COLA provision but pays amounts that are automatically linked to the recent earnings of its beneficiaries; a reduction in net income to bank and thrift insurance funds; and other sources. All of those factors together, however, contribute just $31 billion of the total $324 billion increase in mandatory spending between 1997 and 2002.

Pay-As-You-Go Rules

Since 1990, legislative proposals regarding new or existing entitlement spending programs have been constrained by a pay-as-you-go procedural requirement. The requirement generally prohibits legislated changes in spending on entitlements and other mandatory programs or legislated changes in governmental receipts from increasing the deficit. Under the Budget Enforcement Act of 1990, legislation to create a new entitlement program, expand an existing entitlement program, or cut taxes must be offset. This requirement, which is called pay-as-you-go neutrality, applies not to each new law individually but generally to the cumulative impact of all laws since 1990. It is enforced after the end of each Congressional session for the budget and preceding years. The pay-as-you-go requirement expires at the end of 1998, but presumably will be extended. Although the requirement has little relevance for putting together a deficit reduction plan, it has proven very useful in enforcing plans once they have been adopted. Thus, the saving options in this chapter can be used for deficit reduction and for paying for tax cuts or for new or expanded entitlements.

The pay-as-you-go rule is qualified in several ways. For instance, increases in direct spending or tax cuts for designated emergencies are exempt from the requirement. That emergency provision has only been used once--in March 1993--to extend Emergency Unemployment Compensation benefits. In addition, the Deficit Control Act of 1985 excludes the receipts and mandatory outlays of the Social Security retirement and disability trust funds from all calculations under the act, including the pay-as-you-go requirements. (Social Security is subject to its own set of rules, however, which are designed to hamper legislation that would lessen the balances in the trust funds.)

If the pay-as-you-go rule is violated, a sequestration--an automatic cutback applying to nonexempt mandatory programs--must take place. But many of the major benefit programs (such as Social Security, federal employees' retirement, and most means-tested programs) are wholly exempt from the automatic cuts. In addition, other programs (including Medicare and guaranteed student loans) are subject to limited cuts. Those rules leave a relatively small portion of mandatory spending to bear the brunt of a large pay-as-you-go sequestration. To date, however, there has never been a sequestration for a pay-as-you-go violation. For more information on the pay-as-you-go rule, see Chapter 1.

Program Trends and Options

In addition to suggestions for curtailing spending in specific programs, broad approaches to restraining the growth of entitlement spending have been suggested. One would place a cap on spending; another would create block grants; a third would apply a means test to restrict eligibility for benefits.

Many proposals have been made in the past that are aimed at placing an enforceable cap on mandatory spending. For example, many would tie the growth of spending for individual programs to inflation and an increase in the size of the eligible population. Often a transitional growth factor would be added, allowing the new policy to be phased in. Some proposals would also establish an across-the-board sequestration procedure to prevent a breach of the cap. Many advocates of this approach, however, have not accompanied the call for a mandatory cap with policy proposals to achieve the reductions in individual programs that would be needed to avoid sequestration. And in many cases, such a sequestration would involve large percentage cuts in benefits.[1]

Another way of capping mandatory spending is to replace open-ended matching programs with block grants to state or local authorities. For example, Title I of the Personal Responsibility and Work Opportunity Reconciliation Act of 1996 (Public Law 104-193) combined several entitlement programs--Aid to Families with Dependent Children, Emergency Assistance, and the Job Opportunities and Basic Skills Training program--into a single block grant with a fixed funding level. Unlike across-the-board sequestrations, this approach could be used to achieve programmatic objectives and restrain the growth of entitlement spending.

Applying a means test to entitlement programs has also been suggested as a broad strategy for curbing the growth of such spending. One approach would control entitlements through a form of means-testing under which benefits for people with the highest incomes would be cut most. Several ways of carrying out the means-testing approach are discussed in ENT-45.

The other options in this chapter would reduce the growth of entitlement spending on a program-by-program basis. For instance, new program rules could limit those who qualify for benefits or reduce the amount of benefits provided (see ENT-22 and ENT-35 for examples) or cut payments to providers of services (see ENT-21). See also Chapter 5 for a consideration of ways to cut the Medicare and Medicaid programs over the next five years.

Social Security and Other Retirement and Disability Programs

Spending on Social Security, the largest entitlement program, is expected to total $364 billion in 1997 and provide benefits to more than 44 million elderly and severely disabled workers and members of their families (see Table 4-2). Outlays for benefits have grown over the years as a result of the increase in recipients among existing eligible groups, cost-of-living increases in benefits, and the higher real earnings--hence higher benefits--of newly retired workers. The Social Security Amendments of 1983 made major changes in the program to improve its financial standing. Although most changes involved financing and coverage, others delayed annual cost-of-living increases to recipients and made some benefits subject to taxation. The amendments also increased the age of eligibility for full retirement benefits from 65 to 67, phasing in the change during the first quarter of the next century.

1. For more information on using an enforceable cap, see Congressional Budget Office, *Mandatory Spending Control Mechanisms*, CBO Paper (February 1996).

Table 4-2.
CBO Baseline Projections for Mandatory Spending, Including Deposit Insurance
(By fiscal year, in billions of dollars)

	Actual 1996	1997	1998	1999	2000	2001	2002
			Means-Tested Programs				
Medicaid	92	99	105	114	123	133	144
Food Stamps[a]	25	25	25	27	28	29	29
Supplemental Security Income	24	28	26	28	32	29	34
Family Support	18	19	20	21	21	22	22
Veterans' Pensions	3	3	3	3	3	3	3
Child Nutrition	8	8	8	9	9	10	10
Earned Income Tax Credit	19	21	22	22	23	24	25
Student Loans	4	3	3	3	3	4	4
Other	4	4	4	5	5	6	6
Total	196	208	217	232	249	259	277
			Non-Means-Tested Programs				
Social Security	347	364	381	400	420	441	464
Medicare[b]	191	209	227	248	273	286	314
Subtotal	538	573	608	648	693	726	777
Other Retirement and Disability							
Federal civilian[c]	44	46	49	51	54	57	60
Military	29	30	31	32	33	34	35
Other	5	5	5	5	5	5	5
Subtotal	77	81	84	88	92	96	100
Unemployment Compensation	22	23	24	26	28	29	30
Deposit Insurance	-8	-12	-4	-3	-1	d	d
Other Programs							
Veterans' benefits[e]	17	19	20	21	23	20	22
Farm price supports	5	6	7	7	7	5	5
Social services	5	5	5	5	6	6	6
Credit reform liquidating accounts	-9	-7	-7	-7	-7	-6	-6
Other[f]	14	19	21	19	22	26	27
Subtotal	33	42	46	46	50	51	54
Total	662	707	758	805	861	902	962
			Total				
All Mandatory Spending	859	916	976	1,037	1,110	1,161	1,239

SOURCE: Congressional Budget Office.
NOTE: Spending for benefit programs shown above generally excludes administrative costs, which are discretionary.
a. Includes nutrition assistance to Puerto Rico.
b. Spending for Medicare excludes premiums, which are considered offsetting receipts.
c. Includes Civil Service, Foreign Service, Coast Guard, other retirement programs, and annuitants' health benefits.
d. Less than $500 million.
e. Includes veterans' compensation, readjustment benefits, life insurance, and housing programs.
f. Includes the Universal Service Fund.

Baseline projections for Social Security spending reflect the influence of the above factors on the program through 2002. The increase in the number of aged people benefiting from Social Security has slowed in recent years. Although that trend will continue for several more years, as the relatively small group of people born during the 1930s becomes eligible, it will be partially offset by the aging of the baby boomers as they move into their late 40s and early 50s, when disability incidence rates are higher.

Although the Social Security program has special rules under the Deficit Control Act of 1985 and is not included in the pay-as-you-go budget discipline, it nonetheless accounts for two-fifths of entitlement spending; cutting it would reduce the total budget deficit. Options to alter the program's benefit structure are considered in ENT-31 through ENT-34. In addition, restraint on the annual cost-of-living adjustment for Social Security is a major component of ENT-44, which considers non-means-tested retirement and disability entitlements. Similar options, as well as more fundamental changes in the Social Security program, were considered in the *Report of the 1994-1996 Advisory Council on Social Security*. The major focus of the council was to develop recommendations for improving the long-term financial status of the program.

Other retirement and disability programs--which will cost $81 billion in 1997, or about 9 percent of entitlement spending--are dominated by the government's civilian and military retirement programs. Spending on those programs is influenced by factors similar to the ones affecting Social Security, and outlays are expected to increase at similar rates in CBO's baseline. ENT-26 and ENT-44 contain options that would modify benefits for former federal workers.

Means-Tested Entitlement Programs Excluding Medicaid

Means-tested entitlement programs include Food Stamps; Supplemental Security Income (SSI), which is for the low-income aged, blind, and severely disabled; pensions for needy veterans who are aged or disabled; child nutrition (such as the School Lunch Program); and the refundable portion of the EITC, which benefits low-income working families with children. Costing $109 billion in 1997, expenditures on means-tested programs other than Medicaid represent approximately 12 percent of entitlement spending.

The Personal Responsibility and Work Opportunity Reconciliation Act of 1996, otherwise known as welfare reform, partially offsets the growth in mandatory spending. Welfare reform is expected to reduce the deficit by $51 billion in the period 1998 through 2002. Most of the savings are in the SSI and Food Stamp programs, both of which will be reduced by $5 billion in 2002. The reduction in those two programs' benefits results from restricting the eligibility of legal aliens for welfare benefits, tightening the eligibility requirements for disabled children under the SSI program, and modifying the benefits and eligibility requirements of the Food Stamp program.

Annual federal spending for the refundable portion of the EITC rose from about $1 billion in the early 1980s to $9 billion in 1993, largely as a result of the expansions included in the Tax Reform Act of 1986 and the Omnibus Budget Reconciliation Act of 1990 (OBRA-90). As a result of changes in OBRA-93 that increased benefits, spending for the EITC is projected to double approximately, from $11 billion in 1994 to $21 billion in 1997, before leveling off. ENT-24 and ENT-28 would reduce federal spending on certain means-tested programs by targeting benefits more narrowly and limiting federal payments for administering some of those programs.

Subsidized student loans are another means-tested entitlement, although the restrictions are not as stringent as for many such programs. (Unsubsidized loans are also available for those students who are from families with higher incomes.) Students can borrow through those programs to attend postsecondary educational institutions. The annual budgetary cost of student loans --as well as that of other federal loan and loan guarantee programs--consists of the present value of current and expected future subsidies for loans that originate in that specific year. Student loans are not as directed toward needy students as are Pell grants, which constitute the main discretionary program providing aid to postsecondary students. CBO's baseline projects that program costs for student loans will total between about $3 billion and $4 billion through 2002. ENT-20 through ENT-22 would reduce the federal cost of those loans by reallocating part of the cost to lenders, schools, students, and their families.

Aid to Jobless Workers

The Federal-State Unemployment Compensation Program (UC) and the much smaller federal Trade Adjustment Assistance (TAA) program are entitlement programs that provide assistance specifically to unemployed workers. The TAA program offers income-replacement benefits, training, and related services to workers unemployed as a result of competition from imports. ENT-27 would eliminate this program.

CBO's baseline for the UC program projects that spending will rise to about $30 billion in 2002. Unemployment compensation is included in the federal budget, but state laws set most of the benefit and tax provisions. Thus, states can generally offset federal options that would reduce regular UC spending, and permanent budgetary savings cannot usually be attributed to federal changes in regular UC rules. As a result, this chapter does not include federal options limiting regular UC benefits.

Non-Means-Tested Veterans' Programs

Veterans' benefits constitute another category of federal entitlement spending. CBO projects that non-means-tested entitlement spending for veterans' compensation, readjustment benefits, life insurance, and housing programs will total about $19 billion in 1997, or about 2 percent of all entitlement spending during that year. ENT-35 through ENT-40 would restrict federal spending on veterans' benefits by limiting eligibility for certain programs and raising costs to participants. In addition, ENT-40 would reduce Social Security disability payments for some people who also receive veterans' compensation.

Farm Income Support Programs

The Federal Agricultural Improvement and Reform Act of 1996, which governs most federal support for farmers, is substantially changing many farm programs. Farmers growing the major supported crops--wheat, corn and other feed grains, cotton, and rice--need no longer set aside a portion of their tillable land to be eligible for payments, as they have for many years. And unlike the practice in the past, the size of the direct payment generally will not change with commodity prices. Rather, farmers who signed so-called "production flexibility contracts" will get government checks according to a formula that divides a fixed amount of money among crops and then among farmers based on their eligible acreage and past yields. Farmers must comply with some conservation rules to stay eligible for payments. Few farmers have declined.

Some protection from low prices remains, but at reduced levels. The result is that producers of major crops will respond more to the needs of the market and less to the requirements of government programs. Most analysts believe that this increased market orientation will be good for agriculture generally, although some farmers will be hurt by changes in the federal safety net.

The new law also changed the dairy program. For decades, prices of dairy products have been supported through direct government purchases. Support prices are now being cut and price supporting purchases will end in 1999. Dairy producers will still benefit from federal regulations that keep the price of milk used for fluid products above that used for manufactured products, such as butter, cheese, and nonfat dry milk.

The government also supports peanuts, tobacco, and sugar by different combinations of production controls, import restraints, and price-supporting loans. For those crops, most of the support farmers receive is through market prices that are kept artificially high by government programs.

CBO projects that spending for farm income support programs will be $6 billion in 1997 (up from $5 billion in 1996), rising to $7 billion in 1998 before declining to $5 billion by 2002. (Agriculture also benefits from programs funded through appropriations. Such discretionary programs, including agricultural research and extension, some export promotion, and farm loan programs, are covered in Chapter 3.)

Four options reducing agricultural spending are included in this chapter. ENT-07 through ENT-09 would lower federal outlays by cutting programs that subsidize or promote exports of farm commodities. ENT-10 would increase an assessment that applies to growers and purchasers of tobacco.

User Fees and Other Changes in Direct Spending

Fees can be charged to users of resources, facilities, or services provided by the federal government to raise funds to help pay for them and promote their more efficient use. Options describing modified or higher fees in a variety of areas are included in this chapter (ENT-01 through ENT-06, ENT-11, ENT-16 through ENT-19, ENT-23, ENT-46, and ENT-47). For example, the federal government could index nuclear waste disposal fees for inflation or establish charges for airport takeoff and landing slots.

Receipts from fees would be treated under the Deficit Control Act of 1985 as spending changes in entitlements or mandatory programs if the legislation changing the fees originated in an authorizing committee. In that case, the added receipts from fees would be credited to the pay-as-you-go scorecard.

ENT-01 RESTRUCTURE THE POWER MARKETING ADMINISTRATIONS TO CHARGE HIGHER RATES AND END DIRECT SUBSIDIES

	Annual Added Receipts (Millions of dollars)					Five-Year Cumulative Total
	1998	1999	2000	2001	2002	
Addition to Current-Law Receipts	0	210	210	210	210	840

Hydroelectric power generated at 129 federally owned plants is sold by power marketing administrations (PMAs), which are agencies of the Department of Energy. In recent years those federally owned hydroelectric plants have generated about 4 percent of the electricity sold in the United States. Under current law, the PMAs must first offer to sell most of this power locally to rural electric cooperatives, municipal utilities, and other publicly owned utilities (collectively known as preference customers). Any excess PMA power not purchased by preference customers can be sold to investor-owned utilities. Current law requires that those sales be made at cost. This option would eliminate the requirement to offer PMA power first to preferred customers and would allow the PMAs to sell it to the highest bidder. It would also eliminate requirements that the Bonneville Power Administration (BPA) subsidize the residential customers of certain investor-owned utilities in the Northwest.

The continuing restructuring of markets for wholesale electric power is lowering prices for consumers throughout the nation. (Wholesale transactions are generally between power generators and local distribution companies.) The PMAs have long been among the cheapest sources of wholesale power. But the growing presence of low-cost, competitive suppliers and the rising operating costs of aging federal facilities make it unclear how much longer the federal cost advantage can last. Establishing a market rate for PMA power now, while market rates are still above federal rates, would reduce the current deficit. That change might also stem the need for future taxpayer support by stimulating the PMAs to make more cost-effective operating and investing decisions than in the past.

In 1995, the preference customers for PMA power paid an average 2.4 cents per kilowatt-hour (kWh). The Southwestern Power Administration charged the lowest rates (1.3 cents per kWh); the BPA charged the highest (2.6 cents per kWh). Nationwide, private utilities charged municipal and cooperative distributors an average 3.8 cents per kWh. Market rates for new supplies of power--much of it from independent power producers (IPPs)--are generally above PMA rates as well. Only the BPA faces direct competition from IPP rates. This option to establish market rates for PMA power assumes that agencies other than the BPA will raise rates by an average of 10 percent and make federal power more broadly available than today. The BPA, which has recently offered a more competitive, five-year rate package to its preference customers, would not raise rates. Additional receipts generated by increasing rates would total about $65 million a year.

This option would also reduce operating costs of the Bonneville Power Administration by about $145 million a year by ending the agency's residential exchange program. That program lowers the cost of electricity to residential customers of investor-owned utilities in the Pacific Northwest by requiring the BPA to purchase high-cost power from those utilities in exchange for low-cost federal hydroelectric power.

The additional revenues from this option could be used by the PMAs to repay the $14 billion that it cost to construct existing plants. In addition, the current practice of selling power below market rates leads to levels of electricity consumption in PMA service areas that are inconsistent with the government's energy conservation and environmental objectives. Conversely, critics of this option argue that large rate increases that could result from it would adversely affect regional economies. Proponents of continuing to reserve PMA power for use by public utilities maintain that doing so is a more appropriate use of the government's hydro-

electric resources than allowing private companies to profit from the sale of public resources. Proponents of the status quo also say that publicly owned utilities have encouraged widespread use of electricity (especially in rural areas) at low rates.

In 1996, the President signed legislation authorizing the sale of the smallest PMA, the Alaska Power Administration. In 1995, the House Committee on Resources also approved legislation authorizing the sale of the Southeastern Power Administration.

ENT-02 CHANGE THE REVENUE-SHARING FORMULA FROM A GROSS-RECEIPT TO A NET-RECEIPT BASIS FOR COMMERCIAL ACTIVITIES ON FEDERAL LANDS

Savings from Current-Law Spending	Annual Savings (Millions of dollars) 1998	1999	2000	2001	2002	Five-Year Cumulative Total
Budget Authority	180	190	195	200	205	970
Outlays	180	190	195	200	205	970

The federal government owns more than 650 million acres of public lands--nearly one-third of the United States' land mass. Those public lands contain a rich supply of renewable and nonrenewable natural resources: timber, coal, forage for livestock, oil and natural gas, and many nonfuel minerals. Private interests are given access to much of the federal land to develop its resources and generally pay fees to the federal government based on the commercial returns realized. In many cases, the federal government allots a percentage of those receipts to the states and counties containing the resources, as compensation for tax revenues they did not receive from the federal lands within their boundaries. The federal government typically calculates those allotments on a gross-receipt basis before taking account of its program costs. The practice has an important budgetary disadvantage: it sometimes causes the federal government's program costs to exceed its share of receipts. Shifting to a net rather than a gross basis would reduce net federal outlays by $970 million over the 1998-2002 period.

In most cases, the Forest Service is required to allot 25 percent of its gross receipts from commercial activities in the national forests to the respective states and counties. The Department of the Interior allots 4 percent of its timber receipts, an average of 18 percent of its grazing fees, and 4 percent of its mining fees from "common variety" materials to the states; the department's Minerals Management Service (MMS) allots 50 percent of its adjusted onshore oil, gas, and other mineral receipts to the states. The MMS deducts 50 percent of its administrative costs from the gross-receipt calculation before distributing those payments. In effect, the states share 25 percent of the burden of those administrative costs. On certain federal lands--specifically, national forests affected by protection of the spotted owl and the Oregon and California grant lands--payments to states and counties are based on an average of payments made in the past.

Federal savings would be substantial if the Congress required those agencies to deduct their full program costs from their gross receipts before paying the states. The regional jurisdictions would continue to receive the same allotted percentage of net federal receipts and would accrue receipt shares totaling about $685 million in 1998. Net federal outlays would be reduced by about $180 million in 1998 and by about $970 million over five years (1998-2002). The projected savings do not include potential federal cost increases under the Payment in Lieu of Taxes (PILT) program. That program was established in 1976 to offset the effects of nontaxable federal lands on the budgets of local governments. The payments in lieu of taxes to the states are partially reduced by the amount of revenue-sharing payments from federal agencies. Payments under the PILT program would increase by about $30 million a year beginning in fiscal year 1999 if net program receipts were shared and the Congress appropriated such an increase.

Changing the revenue-sharing formula to a net-receipt basis would probably have a negative impact on the economies of the respective states and counties. A significant source of revenue for some states and counties would be reduced. That reduction in revenues might lead to serious cuts in state and county spending. To help alleviate that hardship, the federal agencies could switch gradually to the net-receipt basis over several years.

ENT-03 CHARGE ROYALTIES AND HOLDING FEES FOR HARDROCK MINING ON FEDERAL LANDS

Addition to Current-Law Receipts	Annual Added Receipts (Millions of dollars)					Five-Year Cumulative Total
	1998	1999	2000	2001	2002	
Royalty on Net Proceeds	2	12	8	8	8	38
Royalty on Gross Proceeds	12	55	39	39	39	184
Reauthorize Holding Fees	0	34	34	34	34	136

The General Mining Law of 1872 governs access to hardrock minerals--including gold, silver, copper, and uranium--on public lands. Any holder of more than 10 mining claims on public lands must pay an annual holding fee of $100 per claim, and all claimholders must pay a $25 location fee when recording a claim. But, unlike producers of fossil fuels and other minerals from public lands, miners do not pay royalties to the government on the value of the hardrock minerals. Also, authorization to collect the current holding fee expires in 1998. Estimates place the current gross value of hardrock minerals on public lands at about $700 million--a sum that has diminished greatly in the past few years with increased patenting activity. (In patenting, miners gain title to public lands by paying a one-time fee of $2.50 or $5 an acre.)

The Congress has debated reform of the General Mining Law for the past several years. The 104th Congress included reform measures as part of the Balanced Budget Act of 1995 (H.R. 2491), which the President vetoed. That reform would have required miners to pay a 5 percent royalty on the net proceeds from hardrock mining (that is, sales revenues minus the costs of mining, separation, and transportation). In the 103rd Congress, the House passed legislation (H.R. 322) that would have imposed an 8 percent royalty on the gross proceeds (that is, sales revenues) from mining.

This option considers two types of 8 percent royalties that the Congress could impose on hardrock mineral production from public lands: one on net proceeds (as defined in H.R. 2491), and one on gross proceeds (as defined in H.R. 322). The option would also reauthorize the current holding fee when it expires in 1998 and assumes that such fees would be recorded as offsetting receipts to the Treasury. They are currently counted as offsetting collections to appropriations. Total deficit reduction during the 1998-2002 period from a net proceeds royalty would be about $38 million. Over the same period, deficit reduction from a royalty on gross proceeds would be about $184 million, and from reauthorization of holding and location fees, about $136 million. Those estimates assume that states in which the mining took place would receive 25 percent of the federal royalty receipts. They also assume that there would be no further patenting of public lands.

People in favor of reforming mining law--many of them in the environmental community--argue that low holding fees and zero royalties reduce the costs of production from federal lands compared with those from private lands (where payment of royalties is the rule). That policy encourages overdevelopment of public lands. Mineral reform could encourage other uses of public lands, such as recreation and wilderness conservation.

Opponents of reform argue that without free access to public resources, exploration for hardrock minerals in this country--especially by small miners--would decline. They also argue that royalties would diminish the profitability of many mines, leading to scaled-back operations or closure and, as a result, adverse economic consequences for mining communities in the western states. Because many mineral prices are set in world markets, miners would be unable to pass along new royalty costs to consumers.

Administrative costs to put a net proceeds royalty in place would most likely be greater than those for a gross proceeds royalty, both for the federal government and for miners.

ENT-04 REFORM PUBLIC LAND RECREATION FEE POLICIES

	Annual Added Receipts (Millions of dollars)					Five-Year Cumulative Total
	1998	1999	2000	2001	2002	
Addition to Current-Law Receipts	200	207	215	222	231	1,075

The federal government owns and manages more than 650 million acres of land in the United States. The land is used for a wide variety of purposes, including recreation and associated private concessions for which the government is compensated by fees. Those fees may not provide the government with a fair return. Better pricing could decrease net federal outlays by $200 million in 1998 and by $1.1 billion over five years, alleviate overuse by reducing recreational activity, and encourage quality concessions.

All federal agencies that hold major tracts of land allow recreational access and provide some services to visitors. The services range from maintaining rough hiking trails to operating fully developed recreational facilities, such as campsites and marinas. Entrance and user fees are charged at some locations. The Congress authorized new and expanded fees in 1994, but those still cover only a small portion of the direct costs of visitor services. In 1996, the Congress also approved a three-year (1997-1999) demonstration project involving new fee initiatives at up to 100 park locations. Amounts charged under that temporary authority, however--about $130 million over the demonstration period --will be used for park improvements, not for visitor services.

In 1996, the National Park Service spent an estimated $250 million on visitor services and recovered about $65 million in net fees. Requiring the Park Service to charge fees to cover those direct costs as well as the associated costs of collection would shift that burden to the beneficiaries of the services and improve pricing of public land use. Such fees would lower net federal outlays by $200 million in 1998 and by $1.1 billion over a period of five years.

Arguments against additional increases in fees reflect the view that the national parks and public lands are a vital and accessible part of our national heritage. The social benefits of visits to the parks--especially for the elderly and the poor--far exceed the costs of providing them.

Additional fee increases, however, would shift the costs of police protection and other services from taxpayers to the users of parks. The overcrowding that is now a problem at many parks could be alleviated by an appropriate fee structure. Visits by the poor and the elderly could be encouraged by free-access days or by the cross-subsidization of urban parks, in which fees collected at some parks would be used to offset the costs of maintaining others that have lower or no charges.

ENT-05 RAISE GRAZING FEES ON PUBLIC LANDS

	Annual Added Receipts (Millions of dollars)					Five-Year Cumulative Total
	1998	1999	2000	2001	2002	
Addition to Current-Law Receipts	8	13	15	15	15	66

The federal government owns and manages more than 650 million acres of land in the United States. The land is used for many purposes, including grazing of privately owned livestock. Cattle owners compensate the government for use of the land by paying grazing fees. Those fees may not provide the public with a fair return. In addition, underpricing may lead to overuse. Better pricing could increase federal receipts by $8 million in 1998 and $66 million over 1998-2002 and alleviate overuse by reducing grazing activity.

The Forest Service and the Bureau of Land Management administer livestock grazing on approximately 262 million acres of public rangelands in the West. Those lands provide ranchers with about 31,000 grazing allotments and, at current leasing rates, roughly 20 million animal-unit months (AUMs) of grazing each year. In 1990, the appraised value of public rangeland in six Western states varied between $5 and $10 per AUM. A 1993 study indicated that the Forest Service and the Bureau of Land Management spent $4.60 per AUM in that year to manage their rangelands for grazing. By contrast, the 1994 permit fee was set at $1.98 per AUM under the formula established by the Congress. (The 1996 fee is $1.35 per AUM under the current formula.) The 1993 weighted average lease rate for grazing on private lands in 11 Western states was $10.03 per AUM. Thus, the current fee structure may represent a subsidy for many ranchers who participate in the program.

Various proposals have been introduced in the Congress to increase grazing fees. The proposals would either adjust the fee-setting indexes to reflect livestock markets and leasing rates on private rangeland or replace the existing fee structure with a new, modified market value. An increase in federal receipts resulting from either of those measures depends on the degree to which ranchers reduce their use of AUMs in response to increased fees. One recent proposal would increase grazing fees to $4.00 per AUM over three years. From the third year on, the fee would then be adjusted according to a forage value index based on private land rents, and annual changes in the fee would not exceed 25 percent. The higher fee would increase federal receipts, measured against current law, by approximately $66 million during the 1998-2002 period. Those are the amounts that would be left in the Treasury after deducting the share of receipts paid to states and counties from the increased fees. They do not reflect any additional appropriations for range improvements that could result from added receipts.

Proponents of fee increases believe that low fees subsidize ranchers and contribute to overgrazing and deteriorated range conditions. As an alternative to setting fees administratively, grazing rights might be allocated through a competitive bid process such as that now used by the Forest Service in its Eastern and Southern regions. Disadvantages of that approach are high administrative costs and limited competition. In many cases, only the owners of private lands adjacent to federal lease tracts would be willing to bid for grazing rights. (Current law requires permit holders to own a base property near the federal lease tract). Permit holders are not granted complete control over third-party access to the permit area, but may hope to maintain control by owning and regulating the private lands surrounding the lease tract.

Opponents of increased fees for grazing on public lands believe that higher fees overstate the value of public lands compared with private properties that might be in better condition or offer more favorable lease terms. In addition, low fees encourage permit holders to invest in range improvements. Further, increased fees would cut profit margins for ranchers who use public land, perhaps encouraging them to exceed

the grazing limits and forgo range improvements. Between 1979 and 1983, ranchers spent 16 cents per AUM per year, on average, for range improvements. Under current law, the federal government allocates a fixed percentage of grazing-fee revenue to the Range Betterment Fund. The increase in federal expenditures on range improvements implied by higher fees would offset any decrease in private range improvements.

ENT-06 RECOVER COSTS ASSOCIATED WITH ADMINISTERING U.S. ARMY CORPS OF ENGINEERS PERMITTING PROGRAMS

	Annual Added Receipts (Millions of dollars)					Five-Year Cumulative Total
	1998	1999	2000	2001	2002	
Addition to Current-Law Receipts	0	8	17	17	18	60

The Department of the Army, through the Army Corps of Engineers, administers laws pertaining to the regulation of the navigable waters of the United States, including wetlands. Section 404 of the Clean Water Act requires that any private, commercial, or government agent wishing to dredge or dump fill material in waters or wetlands of the United States must obtain a permit from the Corps. The Corps could recover a portion of its annual regulatory costs by increasing permit fees. Imposing one type of fee structure for section 404 of the Clean Water Act--a cost-of-service fee on commercial applicants--would generate revenue of $8 million in 1999 and $60 million over the 1998-2002 period.

In fiscal year 1997, the Corps estimates that it will receive approximately 65,000 applications for section 404 permits to discharge dredged or fill materials. Under section 404, the Corps is required to evaluate each permit application and approve or deny it on the basis of expert opinion and statutory guidelines. The bulk of permits are quickly approved through outstanding general or regional permits that grant authority for many low-impact activities. Evaluation of permits not covered by outstanding permits may require the Corps to conduct detailed, lengthy, and costly reviews. Statutory requirements may include preparing an environmental impact statement (EIS) as required under the National Environmental Protection Act of 1969.

Fees levied for commercial and private permits cost $100 and $10, respectively. There is no charge for government applicants. Total fee collections fall far short of covering the costs of administering the permitting program, particularly those for applications requiring detailed review or the preparation of an EIS. The Congressional Budget Office (CBO) estimates that reviewing commercial permit applications will cost the Corps about $25 million in 1997. Because commercial permit applications are likely to decrease if fees are increased, CBO estimates that the Corps' total cost of reviewing commercial applicants will also decrease. The Administration's fiscal year 1997 budget included a proposal to create a fee structure that would recover a smaller portion of the costs of administering the permitting program.

Proponents of higher fees would argue that parties seeking a permit, not the general taxpaying public, should bear the cost of permitting, and that because permit seekers are advancing a private interest, the benefits of which accrue to a private party, the costs should be borne by that party. Furthermore, society should not have to pay for a process that advances the interests of a comparative few.

Permit seekers might argue against increased fees from the standpoint of property rights. Why should property owners fund a process that may ultimately deny them the right to use their land as they choose? The goal of the Section 404 permit program is to advance the public interest by protecting wetlands. Because society benefits from wetlands protection, often at the perceived expense of property owners, society should pay. Furthermore, say permit seekers, the regulatory process that property owners must navigate is already onerous; adding yet another cost would further infringe on property rights.

ENT-07 REDUCE LOAN GUARANTEES MADE UNDER THE USDA'S EXPORT CREDIT PROGRAMS BY ELIMINATING GUARANTEES FOR LOANS TO HIGH-RISK BORROWERS

Savings from Current-Law Spending	Annual Savings (Millions of dollars)					Five-Year Cumulative Total
	1998	1999	2000	2001	2002	
Budget Authority	108	143	147	154	159	711
Outlays	108	143	147	154	159	711

The government guarantees short- and intermediate-term loans made by commercial banks to finance foreign purchases of U.S. agricultural commodities, especially grains and oil seeds, and other agricultural products. The Department of Agriculture (USDA) may use those guarantee programs to increase U.S. exports, compete against foreign agricultural exports, and assist some countries in meeting their food and fiber needs, but it cannot use them for foreign aid, foreign policy, or debt rescheduling. Credit terms, in addition to price, are a key element of competition in world markets.

U.S. law requires that borrowers be creditworthy, but some borrowers are riskier than others. If a foreign buyer misses a loan payment, the bank making the original loan submits a claim to the USDA. The USDA reimburses the bank, takes over the loan, and attempts collection. The U.S. government typically guarantees 98 percent of the principal of the loan and a portion of the interest.

This option would limit annual guarantees to $3 billion--about $800 million less than they would be under current law. The estimate of savings assumes that the reduction would derive from eliminating the guarantees for loans to high-risk borrowers, including but not limited to some countries in the Middle East, North Africa, Eastern Europe, and the republics of the former Soviet Union. That change would reduce outlays by $711 million over the 1998-2002 period, based on the subsidy value of the guarantees.

Proponents of reducing guarantees of credit to high-risk borrowers argue that the potential costs of those high-risk loans do not outweigh the benefits of the increase in U.S. exports, if any, resulting from them. Opponents of reducing the guarantees argue that the benefits do outweigh the potential costs. They maintain that the credit guarantees are vital in retaining the U.S. share of competitive world markets. (Some commodity groups believe that they would export less and receive lower prices for their products without the credits.) Opponents also argue that without the guarantees some countries could not meet their food and fiber requirements.

ENT-08 ELIMINATE THE EXPORT ENHANCEMENT PROGRAM

Savings from Current-Law Spending	Annual Savings (Millions of dollars)					Five-Year Cumulative Total
	1998	1999	2000	2001	2002	
Budget Authority	302	477	504	453	429	2,165
Outlays	302	477	504	453	429	2,165

The Department of Agriculture (USDA) subsidizes the export of agricultural commodities through the Export Enhancement Program (EEP). U.S. exporters participating in the EEP negotiate directly with buyers in a targeted country and then submit bids to the USDA for cash bonuses. The bids include the sale price, tentatively agreed to with the buyer, and the amount of the subsidy or bonus that has been requested by the exporter.

The signatories of the Uruguay Round Agreements Act of the General Agreement on Tariffs and Trade have pledged to reduce both the volume of subsidized exports of agricultural products and budgetary outlays on export subsidies for those products. (The legislation to carry out the Uruguay Round agreements also removes the requirement in U.S. law that the EEP be used only as a response to unfair trade practices, so that it can be used more generally for market promotion and expansion.) Moreover, the 1996 farm bill caps the funding available for the EEP in each year through 2002. Although the Uruguay Round agreements and the 1996 farm bill could restrict the size and cost of the EEP in the future, they will not eliminate it.

Since the program's inception in 1985, the USDA has awarded $7.2 billion in bonuses, mostly to assist wheat exports. The Congressional Budget Office believes that eliminating the EEP would result in lower exports and prices; thus, it expects that increases in outlays for other farm programs would offset some of the savings from eliminating this program. On balance, eliminating the EEP would save almost $2.2 billion during the 1998-2002 period.

On the one hand, the EEP may help to increase U.S. exports or maintain market share. On the other hand, it is not clear how effective the program has been as a counterweight to foreign subsidies, or how effective it will be under a broader mandate. Moreover, some critics argue that the EEP has depressed world commodity prices, thereby penalizing competitors who do not subsidize their exports.

ENT-09 ELIMINATE THE MARKET ACCESS PROGRAM

Savings from Current-Law Spending	Annual Savings (Millions of dollars)					Five-Year Cumulative Total
	1998	1999	2000	2001	2002	
Budget Authority	7	70	90	90	90	347
Outlays	7	70	90	90	90	347

The Market Access Program (MAP), formerly known as the Market Promotion Program, was authorized under the 1990 Food, Agriculture, Conservation, and Trade Act to assist U.S. exporters of agricultural products. The program has been used to counter the effects of unfair trading practices abroad, but the Uruguay Round Agreements Act of 1994 eliminated the requirement that it be used for such purposes. Payments are made to offset partially the costs of market building and product promotion undertaken by trade associations, commodity groups, and some profit-making firms. On the basis of current law, the Congressional Budget Office assumes that $90 million will be allocated annually for the program in the 1998-2002 period. Eliminating the MAP would reduce outlays by $347 million over the next five years.

The program has been used to promote a wide range of mostly high-value products, including fruit, tree nuts, vegetables, meat, poultry, eggs, seafood, and wine. According to a recent report by the General Accounting Office, the Department of Agriculture (USDA) allocated an average of about 35 percent of the funding for the program in the 1991-1994 period to participants promoting brand-name products. The 1996 farm bill prohibits direct MAP assistance for brand promotions to foreign companies for foreign-produced products, or to companies that are not recognized as small business concerns under the Small Business Act, except for cooperatives and nonprofit trade associations.

Some critics of the program argue that participants should bear the full cost of foreign promotions because they benefit directly from them. (It is uncertain how much return, in terms of market development, the program has generated or the extent to which it has replaced private expenditures with public funds.) Some observers note the possibility of duplication because the USDA provides marketing funds through the Foreign Market Development Cooperator Program of the Foreign Agricultural Service and other activities. Many people also object to spending the taxpayers' money on brand-name advertising.

Eliminating the MAP, however, could place U.S. exporters at a disadvantage in international markets, depending in part on the amount of support provided by other countries. Responding to concerns about duplication, some advocates of the MAP note that the program is different from other programs, in part because it has focused on foreign retailers and consumer promotions. People concerned about U.S. exports of high-value products consider the program a useful tool for developing markets and providing potential benefits for the economy overall.

ENT-10 INCREASE PRODUCER ASSESSMENTS TO PARTICIPANTS IN THE FEDERAL PROGRAM SUPPORTING THE PRICE OF TOBACCO

Savings from Current-Law Spending	Annual Savings (Millions of dollars)					Five-Year Cumulative Total
	1998	1999	2000	2001	2002	
Budget Authority	31	30	30	30	30	151
Outlays	31	30	30	30	30	151

The federal government aids producers of tobacco by supporting domestic prices above world market levels. Support comes from a combination of marketing quotas, price-supporting loans, and restrictions on imports. The support program benefits about 125,000 growers and 236,000 holders of marketing quotas. Some quota holders raise the crop themselves, and some rent their quota to growers.

Tobacco is a controversial crop because of the hazards of smoking, and federal support for producers has also been controversial. The program has been modified over time to reduce its costs to the taxpayer. In fact, it does nothing to encourage the use of tobacco. Rather, it raises the price of tobacco products to U.S. consumers, though the effect is quite small. The Department of Agriculture estimates that the program may increase the price of a pack of cigarettes by less than 2 cents. For producers, tobacco is an important source of income, particularly in some states. It was the sixth largest cash crop in the United States in 1995, when receipts to tobacco farmers totaled about $2.6 billion. Tobacco is produced in 21 states, and nearly two-thirds of the crop's acreage lies in North Carolina and Kentucky.

The cost of the tobacco price support program varies from year to year. The program can have substantial outlays in a given year, but if it functions as intended, it should have no net cost to the government over time. The reason is that growers and purchasers of tobacco contribute to "no-net-cost accounts" that are used to reimburse the government for costs (excluding administrative costs) of the price support program. In addition to those contributions, growers and purchasers are each assessed 0.5 percent of marketings, valued at the nonrecourse loan rate. Those assessments, started in 1991, were introduced to reduce federal program costs and the budget deficit.

This option would double the current assessment on domestic producers in the tobacco programs. Doing so would bring in receipts of about $151 million over the 1998-2002 period.

Deficit reduction is the main benefit of increasing the assessment. Proponents argue that the government's program gives producers of tobacco substantial benefits, although the support is not in the form of direct payments. They argue that program beneficiaries should not escape the deficit reduction efforts experienced by producers of other supported commodities just because the mechanism of support is indirect. Opponents would argue that since this program adds little to the federal deficit, producers should not be assessed to reduce the deficit.

ENT-11 CHARGE A USER FEE ON COMMODITY FUTURES AND OPTIONS CONTRACT TRANSACTIONS

	Annual Added Receipts (Millions of dollars)					Five-Year Cumulative
	1998	1999	2000	2001	2002	Total
Addition to Current-Law Receipts	57	61	65	69	74	326

The Commodity Futures Trading Commission (CFTC) administers the amended Commodity Exchange Act of 1936. The purpose of the commission is to allow markets to operate more efficiently by ensuring the integrity of futures markets and protecting participants against abusive and fraudulent trade practices. A fee on transactions overseen by the CFTC could cover the agency's costs of operation. Such a fee would be similar to one now imposed on securities exchanges to cover the cost of the Securities and Exchange Commission (SEC).

The Administration's budget for 1996 proposed a transaction fee, set at 10 cents per "round turn transaction." Such a fee, if imposed at the beginning of fiscal year 1998, could generate revenues of $326 million over the 1998-2002 period, which should be sufficient to cover the CFTC's operating expenses during that time. As proposed, the legislation to establish the fee would require the exchanges to remit it four times a year, based on trading volume during the previous quarter. The CFTC would collect the fee. Fee receipts could be classified as either revenues or offsetting receipts.

The main arguments in favor of the fee are based on the principle that users of government services should pay for those services. Participants in transactions that the CFTC regulates, rather than general taxpayers, are seen as the primary beneficiaries of the agency's operations and are therefore users who should pay a fee. Furthermore, the principle of charging such a fee has already been established by the SEC, as well as other federal financial regulators, such as the Office of Thrift Supervision and the Office of the Comptroller of the Currency. Considerations of equity and fairness suggest that not charging a comparable fee to support CFTC operations could give futures traders an unfair advantage over securities traders.

Those who argue against the fee say that such charges tend to encourage evasion by the people who would be subject to them. Users might try to avoid fees by limiting or shifting transactions to activities that are exempt from charges, which could conceivably cause a small fraction of market participants to desert U.S. for foreign exchanges. Major competing foreign exchanges, however, already charge user fees. Even with the proposed 10-cent transaction fee, U.S. futures exchanges may still enjoy a cost advantage over their major foreign competitors.

The Congressional Budget Office expects a user fee of 10 cents to cause only a negligible decrease in transactions because it is small in comparison with the fees already imposed by the exchanges themselves and the industry's self-regulatory organization, the National Futures Association. For example, a market user that is not a member of the Chicago Board of Trade pays a transaction fee of $1.24 on futures trades (a $1 exchange fee, a 10-cent clearing fee, and a 14-cent transaction fee imposed by the National Futures Association). Public participants in the futures markets also pay brokerage commissions typically ranging from $20 to $100 for each transaction. Thus, a 10-cent CFTC transaction fee is small compared with the total existing transaction costs of futures trading, and it would be unlikely to have a significantly adverse effect on the volume of trading on domestic futures exchanges.

ENT-12 ELIMINATE THE FLOOD INSURANCE SUBSIDY ON PRE-FIRM STRUCTURES

	Annual Added Receipts (Millions of dollars)					Five-Year Cumulative
	1998	1999	2000	2001	2002	Total
Addition to Current-Law Receipts	85	367	593	633	665	2,344

The National Flood Insurance Program (NFIP) offers insurance at heavily subsidized rates for buildings constructed before January 1, 1975, or before the completion of a participating community's Flood Insurance Rate Map (FIRM). Owners of post-FIRM construction pay actuarial rates for their insurance. Currently, about 18 percent of all flood insurance coverage is subsidized. The Congressional Budget Office estimates that eliminating the subsidy would yield about $2.3 billion in new receipts over the next five years.

The Federal Emergency Management Agency (FEMA), which administers the flood insurance program, estimates that 36 percent of policyholders are paying subsidized rates for some or all of their coverage. The program subsidizes only the first $35,000 of coverage for a single-family or two- to four-family dwelling, and the first $100,000 of a larger residential, nonresidential, or small business building; various levels of additional coverage are available at actuarially neutral rates. As a result of an April 1996 rate increase, coverage in the subsidized tier is priced at an estimated 38 percent of its actuarial value. The program also offers insurance for buildings' contents; again, policyholders in pre-FIRM buildings pay subsidized prices for a first tier of coverage.

Some subsidized NFIP policyholders purchased their coverage voluntarily, but others did so because of a statutory requirement prohibiting federally insured mortgage lenders from making loans on uninsured properties in "special flood hazard" areas. Despite the subsidies and mandatory purchase requirement, participation remains low. The report of the Interagency Floodplain Management Review Committee estimated that only 20 percent of structures in the nine states of the 1993 Midwest floodplain carried insurance, reflecting both low rates of purchase for properties not subject to the mandatory requirement (which include an estimated one-half of owner-occupied homes) and the apparent unwillingness or inability of many lenders to enforce the mandatory requirement. The Congress included measures to increase compliance with the mandatory requirement and otherwise boost NFIP participation in the National Flood Insurance Reform Act of 1994. Those provisions can be expected to reduce the percentage of current policyholders who would drop their coverage if the subsidies were eliminated, but the Congressional Budget Office estimates that a significant percentage would do so nonetheless.

Proponents of eliminating the subsidy argue that actuarially correct prices would make all property owners in flood-prone areas pay their fair share for insurance protection, and would give them economic incentives to relocate or take preventive measures.

One counterargument asserts that the subsidy should be maintained as part of an effort to increase the low rates of participation by property owners who are not subject to the mandatory purchase requirement. A second argument is that people who built or purchased property before FIRM documented the extent of the flood hazards should not face the same costs as those who made decisions after such information became available. Defenders of the current rates also question the accuracy of FEMA's actuarial tables. Although the current prices cover only 38 percent of estimated average costs over the long run, based on FEMA's mapping exercises, they are roughly equal to average losses incurred in the program to date. Finally, defenders argue that some of the projected benefit to the Treasury will be offset by increased spending by FEMA and the Small Business Administration on disaster grants and loans to people who drop or fail to purchase insurance coverage at the higher rates.

ENT-13 EXTEND AND BROADEN THE FCC'S AUTHORITY TO USE AUCTIONS TO ASSIGN LICENSES TO USE THE RADIO SPECTRUM

	Annual Added Receipts (Millions of dollars)					Five-Year Cumulative
	1998	1999	2000	2001	2002	Total
Addition to Current-Law Receipts	0	900	1,600	1,700	1,800	6,000

The Omnibus Budget Reconciliation Act of 1993 granted the Federal Communications Commission (FCC) authority to auction new licenses to use the radio spectrum. The authority, however, was limited to a five-year period ending on September 30, 1998, and did not apply to many classes of new licenses. The law excluded licenses issued to profit-making businesses that did not charge a subscription fee for telecommunications services. Exemptions included licenses allowing the holders to use the spectrum for such private networks as intracorporate wireless communications systems and permits for intermediary links in the delivery of communications service, such as frequencies used for microwave relays by long-distance telephone companies.

Extending the FCC's authority to auction licenses beyond 1998 and broadening the commission's auction authority to include any license sought by a private business, except nonsubscription terrestrial broadcasting licenses, would increase receipts by $6 billion from 1998 through 2002. Under this option, however, the commission would continue to award licenses to private businesses by comparative hearing when there were not mutually exclusive applications for a band of frequencies. The FCC has conducted 12 successful sales raising almost $23 billion since it was granted the authority to auction licenses. Just how much this option would add to current-law receipts, however, is uncertain. Both telecommunications markets and technologies are changing rapidly and at times unpredictably. The market for licenses used for a variety of private purposes is untested. Moreover, the technical attributes and regulatory limitations carried by the licenses will not be known until the commission allocates frequencies for specific uses. The commission's future actions will have a significant effect on the value of those licenses.

The case for extending the FCC's authority to auction the spectrum and to sell other valuable rights under its regulatory umbrella begins with recognition that the commission has successfully used the auction authority granted to it by current law. The process has gone smoothly, the public is receiving a share of the economic value of the airwaves, and licenses are being awarded promptly to the parties that value them most. Critics of the initial auction statute predicted a very different outcome.

Advocates of broadening the Federal Communications Commission’s auction authority argue that current law draws a false distinction in treating the frequencies used to produce one private good or service in another way than those used to produce a different private good or service. From that point of view, the radio spectrum is a scarce resource. The cost to society of using frequencies in one way translates as benefits that might have been gained by using them in another way. That cost is not changed because a private network or intermediary use is once removed from the ultimate consumer of a good or service.

The case against the option emphasizes a go-slow approach. Early auctions have been successful. Critics might argue that broadening the law to include private networks and intermediary links will increase the cost to businesses seeking to innovate in those areas, thus discouraging the development of new telecommunications technologies and applications. Additionally, some people are concerned that if the United States auctions satellite slots and the associated spectrum, other countries will follow suit, compounding the increased costs to business.

The option considered is only one that would increase receipts collected by the FCC above the level anticipated under current law. Proposals that would direct additional spectrum to be cleared of current users and made available for auction would increase estimated receipts. Alternatively, the Congress could impose an annual fee on the holders of licenses who did not obtain them at auction, auction all of those licenses not originally assigned by auction at the time of their renewal, or allow license holders to pay for the right to use their spectrum assignments more flexibly.

ENT-14 AUCTION A PORTION OF THE TELEVISION SPECTRUM

	Annual Added Receipts (Millions of dollars)					Five-Year Cumulative Total
	1998	1999	2000	2001	2002	
Upfront Auction						
Addition to Current-Law Receipts	2,500	7,500	2,500	0	0	12,500
Accelerated Return Plan						
Addition to Current-Law Receipts	0	0	0	0	9,700	9,700
"60-69" Plan						
Addition to Current-Law Receipts	300	1,100	400	0	0	1,800

The impending transition to advanced television will allow more efficient use of the radio spectrum and could generate additional receipts between 1998 and 2002. Under one option that would auction new slots for television broadcasting--the "upfront auction" or "second-channel auction"--receipts could increase by $12.5 billion between 1998 and 2000. Another option, an "accelerated return plan," would speed up the Federal Communications Commission's (FCC's) current advanced television transition plan and could increase receipts by $9.7 billion in 2002. A third option that would auction the unused portions of spectrum in channels 60 to 69 could raise $1.86 billion by 2000. Those options are illustrative and do not correspond directly to any current legislative proposals. The Congressional Budget Office's scoring of actual legislation would depend on language specifying when licenses would be available, the rights of new licensees versus those of current holders, restrictions on the types of services licensees would provide, and the amount of additional spectrum to be licensed by auction.

The radio "spectrum" does not exist as a physical object; rather, it is a conceptual tool used to organize and map a set of physical phenomena. Electric and magnetic fields produce waves that move through space at different frequencies (defined as the number of times that a wave's peak passes a fixed point in a specific period of time), and the set of all possible frequencies is called the electromagnetic spectrum. The subset of frequencies from 3,000 hertz (cycles per second) to 300 billion hertz--or 3 kilohertz to 300 gigahertz--is known as the radio spectrum.

Currently, just over 400 megahertz (MHz) of the radio spectrum in several frequency blocks between 54 MHz and 806 MHz is allocated to television broadcasting. Adopting digital technology will decrease interference problems and allow those frequency bands to accommodate twice as many 6 MHz slots--the amount of spectrum now granted a single analog television channel--for television broadcasting. Using digital television technology, each of those slots could be subdivided into four to six channels of the current quality, or used as a block to provide a single channel of improved quality television--so-called high-definition television. In order to watch digital television, however, viewers will need to replace their current TV sets or acquire converter devices similar to those now used by direct broadcast satellite subscribers.

The FCC is considering a plan to provide each holder of a broadcast license with an additional 6 MHz slot, a second channel, without charge. During a transition period of approximately 15 years, broadcasters would have the use of their old analog slot and the new

digital slot, allowing them to transmit both an analog and a digital signal and allowing viewers time to adopt the new technology. At the end of the transition, broadcasters would stop transmitting the analog signal and would return that spectrum to the FCC for allocation to other uses. Ultimately, the new digital channels could be "repacked" and accommodated within about 60 percent of the spectrum that is now allocated to television broadcasting in order to free up large contiguous blocks of spectrum for other uses. According to the FCC, the plan would make 138 MHz of spectrum available nationwide for auction after the transition.

Several proposals and variations of proposals that would either modify or significantly change the FCC's preliminary plan have received public attention. One, the upfront auction, would create a number of new digital slots equal to the number of analog channels. As early as 1997, the new digital slots would be auctioned to the highest bidders, who would be required to offer a minimum amount of digital broadcast service but would otherwise be free to put any excess spectrum to whatever use was most profitable and would not interfere with the rights of other license holders. Analog broadcast licensees could continue to broadcast and would be permitted to buy a digital slot without selling their analog channel. To that end, legislation would have to specify relief from current limits on station ownership. Current licensees could also convert their analog license to a digital license after a period of time and notification to their service area.

Alternatively, the accelerated return plan considered here proposes to speed up the Federal Communications Commission's plan to auction the returned analog spectrum. The key departure from the FCC plan as described above is that the transition period would not extend beyond 2005, and the rights to use the new spectrum would be auctioned in 2002--three years before the winning bidders could use it.

A third option would auction overlay licenses giving winning bidders rights to unused portions of the 60 MHz of spectrum between channels 60 and 69. Those channels are lightly used now, with only 97 analog TV stations nationwide, and the FCC plan could add as few as 35 digital stations. Consequently, some portions of the TV spectrum could be reallocated early in the transition process envisioned in the FCC plan. The version of the 60-69 plan considered here would otherwise follow that process and would require licensees to avoid interfering with television stations during the transition period.

Supporters of the options argue not only that each would raise federal receipts, but also--and perhaps more important--that they would increase the productivity of spectrum use by applying the discipline of market forces to the TV frequencies sooner than under the FCC plan. Each of the three options would do so in different ways, however, with different combinations of advantages and disadvantages.

The upfront auction, for example, would allow the market to determine who gets the digital channels, what they are used for (subject to the minimum requirement for TV broadcasting), and how long analog TV continues. It would not, however, facilitate repacking to clear large blocks of spectrum for new uses. The accelerated return plan would clear large spectrum blocks, just as the FCC plan would; because of its shorter transition period, the cleared frequencies would be available for valuable new services sooner, but more viewers would incur costs to replace or adapt their analog TV sets. To avoid imposing those additional costs, the 60-69 plan would settle for putting unused frequencies in the upper TV channels to new uses quickly and defer clearing the rest of the spectrum until the end of the longer transition period envisioned in the FCC plan.

Opponents of the upfront auction argue that it would be unfair to current broadcasters, especially those who bought stations in recent years under the expectation that the FCC would carry out its proposal to loan each broadcaster a second channel for digital operations. More generally, opponents of all three options argue that only the FCC plan allows enough time and spectrum for set manufacturers, providers of TV services, and viewers to make a smooth transition from analog to digital broadcasting.

ENT-15 INCREASE COPYRIGHT REGISTRATION FEES

	Annual Savings (Millions of dollars)					Five-Year Cumulative Total
	1998	1999	2000	2001	2002	
Addition to Current-Law Receipts	11	12	12	13	13	61

The government grants copyright protection to "original works of authorship" such as literary, dramatic, musical, and artistic works. The Copyright Office, part of the Library of Congress, charges a fee to register a copyright, but those fees do not cover the direct cost of administering copyright registration and related activities. Raising registration fees to recover the direct cost of those activities would reduce outlays or increase receipts by $11 million in 1998 and by $61 million over the 1998-2002 period. Increasing the copyright fee would impose an additional mandated cost, equal to the fee increase, on the private sector. The costs would not exceed the threshold for private-sector mandates.

Copyright owners have the exclusive right to reproduce, distribute, perform, or display a protected work and to develop derivative works based on the original. Copyright owners enjoy those rights even if they do not register their copyrights. Registration confers two additional benefits to copyright owners. First, courts treat the certificate of registration as prima facie evidence of a valid copyright. Second, registration allows copyright owners to receive statutorily defined damages and attorneys' fees if a court finds that the copyright has been infringed. Many owners feel that the benefits are worth the $20 registration fee; in recent years, the Copyright Office has processed more than 600,000 registrations a year.

Copyright registration is socially beneficial for the following reasons: first, it helps to clarify the owner's property rights and encourage creative activities. Second, in most cases applications for copyright registration must include copies of the copyrighted work. Those copies are made available to the Library of Congress for its collections. In recent years, the library has received books and other materials worth between $13 million and $20 million through the copyright deposit requirement. Finally, copyright registrations are used to compile a publicly available database of published and unpublished materials.

Copyright registration fees generated about $15 million in offsetting collections in fiscal year 1995. That represents about two-thirds of the direct cost of registration and related processing. Copyright fees were last increased in 1991, when the Congress raised the price from $10 to $20. The Congress also gave the Copyright Office the authority to raise its fees every five years, but limited increases to reflect the change in the consumer price index. The Copyright Office chose not to raise fees in 1995. During 1996, the Congress considered several proposals that would require copyright fees to recover the full cost of administering the registration process.

The argument for raising copyright fees is the same one as that for most user fees. When a government service benefits a specific group--in this case copyright owners--the cost of providing that service should be borne by that group. In the first half of this century, registration fees covered the cost of administering the registration process. After 1948, however, fees were not increased sufficiently to cover the growing cost of copyright registrations. This proposal would return the costs currently borne by all taxpayers to those who register their copyrights.

The main argument against raising fees is the possibility that doing so will deter some from registering their copyrighted material. In addition to the obvious effect on the revenues expected from a fee increase, such behavior would reduce the effectiveness of the Copyright Office in performing its other missions. The registration process is a relatively efficient way of compiling information for the public database and of enforcing the mandatory deposit requirement for published materials. If registration activity declines, the

Copyright Office may be forced to rely on other, more costly means of obtaining materials on behalf of the Library of Congress. Conceivably, increased reliance on those measures could cost more than the increase in revenues generated by the higher fees.

In order to recover the direct cost of the copyright registration process, fees must be increased to about $35 or $40, almost double the current fee. When the Congress doubled registration fees in 1991, registration activity fell by up to 10 percent. Another doubling of fees could have a comparable effect. The effect on registration activity could be reduced, however, by using a fee structure that minimizes the additional registration costs for individuals and small businesses.

ENT-16 IMPOSE USER FEES ON THE INLAND WATERWAY SYSTEM

	Annual Added Receipts (Millions of dollars)					Five-Year Cumulative Total
	1998	1999	2000	2001	2002	
Addition to Current-Law Receipts	439	590	613	633	653	2,928

The Congressional Budget Office estimates that the Congress annually appropriates about $650 million for the nation's system of inland waterways. Of that total, about $475 million is for operation and maintenance (O&M) and about $175 million is for construction. Current law allows up to 50 percent of inland waterway construction to be funded by revenues from the inland waterway fuel tax, a levy on the fuel consumed by barges using most segments of the inland waterway system. All O&M expenditures are paid by general tax revenues.

Imposing user fees high enough to recover fully both O&M and construction outlays for inland waterways would reduce the federal deficit by $439 million in 1998 and $2.9 billion during the 1998-2002 period. The receipts could be considered tax revenues, offsetting receipts, or offsetting collections, depending on the form of the implementing legislation. Receipts could be increased by raising fuel taxes, imposing charges for lockage, or imposing fees based on the weight of shipments and distance traveled. These estimates do not take into account any resulting reductions in income tax revenues.

The advantage of this option is the beneficial effect of user fees on efficiency. Reducing subsidies to water transportation should improve resource allocation by inducing shippers to choose the most efficient transportation route, rather than the most heavily subsidized one. Moreover, user fees would encourage more efficient use of existing waterways, reducing the need for new construction to alleviate congestion. Finally, user fees send market signals that identify the additional projects likely to provide the greatest net benefits to society.

The effects of user fees on efficiency would depend in large measure on whether the fees were set at the same rate for all waterways or according to the cost of each segment. Since costs vary dramatically among the segments, systemwide fees would offer weaker incentives for cost-effective spending because they would cause users of low-cost segments to subsidize users of high-cost segments. Fees based on costs of each segment, by contrast, could cause users to abandon high-cost segments of the waterways.

One argument in favor of federal subsidies is that they may promote regional economic development. Assessing user fees would limit that promotional tool. Reducing inland waterway subsidies would also lower the income of barge operators and grain producers in some regions, but those losses would be small in the context of overall regional economies.

ENT-17 ESTABLISH CHARGES FOR AIRPORT TAKEOFF AND LANDING SLOTS

	Annual Added Receipts (Millions of dollars)					Five-Year Cumulative Total
	1998	1999	2000	2001	2002	
Addition to Current-Law Receipts	500	500	500	500	500	2,500

The Federal Aviation Administration (FAA) has established capacity controls at four airports: Kennedy International and La Guardia in New York, O'Hare International in Chicago, and Washington National in the District of Columbia. This proposal would charge annual fees for takeoff and landing rights at those airports.

Takeoff and landing slots were instituted in 1968 to control capacity and were allocated without charge by the FAA. A total of about 3,500 air carrier slots exist, and there are an additional 1,400 commuter and general aviation slots at the four FAA-controlled airports. Airlines are allowed to buy and sell slots among themselves with the understanding that the FAA retains ultimate control and can withdraw the slots or otherwise change the rules for their use at any time. The slots have value because the demand for flights at times exceeds the capacity of the airports and the air traffic control system.

Estimating the revenue from slot charges is difficult. Airlines generally have not reported the prices they have paid for slots, and even when the value of a transaction is available, the slot value is unclear because slot sales often include other items of value, such as gates. In addition, slot values vary by airport, time of day, season, and other factors. Because the FAA reserves the right to withdraw and add slots and change the rules affecting their use, airlines that buy slots from other carriers must factor in uncertainty when deciding how much a slot is worth. The amount of revenue that could be obtained from annual charges would depend on similar factors, including the length of the lease. For those reasons, the Congressional Budget Office's estimates are somewhat equivocal. Revenues are estimated to be about $500 million annually and $2.5 billion over the 1998-2002 period. But they could be higher or lower depending on the structure of the leasing arrangements--such as length, whether slots could be subleased, and usage requirements--as well as market conditions affecting the airline industry.

The main argument in favor of establishing charges for slots is that since the slots reflect the right to use scarce public airspace, airports, and air traffic control capacity, private firms and individuals should not receive all the benefits that result from that scarcity. Instead, they should share it with the public owners of the rights. Further, the charges would serve as incentives to put those scarce resources to their best use.

The main argument against this proposal is that the scarcity of slots at the four airports arises principally from a lack of land and runway space; the fees are not intended to provide increased capacity. Further, if the current prices paid by airlines in the private sale of slots already accurately reflect their value, this proposal might not produce a better allocation of those scarce resources; the result would be only a redistribution of the benefits from their use between the private and public sectors.

ENT-18 ESTABLISH USER FEES FOR AIR TRAFFIC CONTROL SERVICES

	Annual Added Receipts (Millions of dollars)					Five-Year Cumulative Total
	1998	1999	2000	2001	2002	
Addition to Current-Law Receipts	790	1,627	1,675	1,726	1,777	7,595

The Federal Aviation Administration (FAA) manages the air traffic control (ATC) system, which serves commercial air carriers, military planes, and such smaller users as air taxis and private planes. Services provided include air traffic control towers that assist planes in takeoffs and landings, air route traffic control centers that guide planes through the nation's airspace, and flight service stations that assist smaller users. The FAA employs more than 17,000 air traffic controllers as well as sophisticated software to perform those tasks. The total cost of operating, maintaining, and upgrading the ATC system was about $6.5 billion in 1995.

About half of the operating cost of ATC is financed through annual appropriations from the general fund. Appropriations from the Airport and Airway Trust Fund pay for the other half of ATC operations and for facilities and equipment, research, engineering and development, and such non-ATC activities as airport improvement. The trust fund has been financed by excise taxes on airline passenger tickets, international departures, cargo, and fuel used by general aviation. Those taxes lapsed on January 1, 1996, but were reinstated for the period from August 26, 1996 to December 31, 1996. Whether or not they are reinstated, they do not affect this option because the receipts from this option would cover the portion of ATC costs borne by the general fund. The receipts could be considered tax revenues, offsetting receipts, or offsetting collections, depending on the form of the implementing legislation. These estimates do not take into account any resulting reductions in income tax revenues.

Over the past two years, several proposals have been advanced for reorganizing the FAA and spinning off its air traffic control functions to a private or quasi-public corporation. Such an entity would have to charge users for its services. If air traffic control remains within the FAA, the agency could impose user fees to cover the portion of ATC costs paid by the general fund.

Users could be charged according to the number of facilities they used on a flight and the marginal costs of their use at each facility. If users paid the marginal costs that the ATC system incurs on their behalf, the deficit would be reduced by about $790 million in 1998 and $7.6 billion over the 1998-2002 period, assuming that the new charges would be levied in the middle of fiscal year 1998. The savings in this option are based on estimates of marginal costs made in 1987, adjusted for inflation. The FAA is revising its allocation of costs.

Levying fees that reflect costs would encourage users to moderate their demands. Small aircraft operators might cut back on their consumption of ATC services, freeing controllers for other tasks and increasing the overall capacity of the system. An additional benefit of efficient fees is that, on the basis of user response, planners can judge how much new capacity is needed and where it should be located.

The main argument against this option is that it would raise the cost to users of ATC services. Such a move could weaken the financial condition of commercial air carriers. For general aviation, it also could cause a decline in the demand for small aircraft produced in the United States.

ENT-19 INCREASE USER FEES FOR FAA CERTIFICATES AND REGISTRATIONS

	Annual Added Receipts (Millions of dollars)					Five-Year Cumulative Total
	1998	1999	2000	2001	2002	
Addition to Current-Law Receipts	3	3	4	4	5	19

The Federal Aviation Administration (FAA) oversees a large regulatory program to ensure safe operation of aircraft within the United States. It oversees and regulates the registration of aircraft, licensing of pilots, issuance of medical certificates, and other similar activities. The FAA issues most licenses and certificates free of charge or at a price well below its cost to provide such regulatory approvals. For example, the current fee for registering aircraft is $5, but the cost to the FAA of providing the service is closer to $30. The FAA estimates the cost of issuing a pilot's certificate to be $10 to $15, but it does not charge for one. Imposing fees to cover the costs of the FAA's regulatory services could increase receipts by an estimated $19 million over the 1998-2002 period. If those fees were credited to the FAA's operations account as offsetting collections (as is the current general aviation registration fee), the agency's appropriation could be reduced by a corresponding amount without reducing its budget. Net savings could be somewhat smaller than those shown if the FAA needed additional resources to develop and administer fees.

The Drug Enforcement Assistance Act of 1988 authorizes the FAA to impose several registration fees as long as they do not exceed the agency's cost of providing that service. For general aviation, the act allows fees of up to $25 for aircraft registration and up to $12 for pilots' certificates (plus adjustments for inflation). Setting higher fees would require additional legislation. The FAA has initiated a rulemaking proceeding to consider raising those fees. Imposing other fees may require legislation; they could be authorized under legislation that the Congress is considering to overhaul the FAA.

Increasing regulatory fees might burden some aircraft owners and operators. That effect could be mitigated by scaling registration fees according to the size or value of the aircraft rather than the cost to the FAA. FAA fees based on the cost of service, however, would be comparable to automobile registration fees and operators' licenses and probably not out of line with their value.

ENT-20 REDUCE SUBSIDIES FOR LOANS TO STUDENTS AND PARENTS

Savings from Current-Law Spending	Annual Savings (Millions of dollars) 1998	1999	2000	2001	2002	Five-Year Cumulative Total
Raise the Loan Origination Fee						
Outlays	200	305	320	335	355	1,515
Charge All Student Borrowers Interest While They Are Attending School						
Outlays	1,740	2,625	2,730	2,865	3,005	12,965
Charge All Student Borrowers Interest During the Six-Month Grace Period						
Outlays	305	455	470	495	520	2,245
Raise Interest Rates on Student Loans After the Six-Month Grace Period						
Outlays	260	410	430	450	475	2,025
Raise Interest Rates on Loans to Parents						
Outlays	135	155	175	180	190	835

Federal student loan programs afford postsecondary students and their parents the opportunity to borrow funds to attend school. The Higher Education Amendments of 1992 created a "subsidized" program for students defined as having financial need. It also created two "unsubsidized" programs, one for students from families with greater financial resources and another for parents of students. In the subsidized program, the federal government incurs interest costs on the loans while the students are in school and during a six-month grace period after they leave. In the unsubsidized programs, borrowers are responsible for the interest costs, although for students, payments can be made after they leave school. The government recoups part of the cost of those programs by collecting between 3 percent and 4 percent of the face value of each loan as an origination fee.

Borrowers benefit from both the subsidized and unsubsidized programs because the interest rate they are charged is tied to the cost of borrowing by the federal government. Although the government provides no budgeted subsidy in allowing borrowers access to funds at this low rate, the rate is considerably lower than that charged to most borrowers in the private credit market. In addition, the economic subsidy is larger in the subsidized program because interest is not charged until six months after the students leave school, whereas it begins to accrue immediately in the unsubsidized programs.

Federal costs could be reduced by increasing the loan origination fee charged to borrowers or by increasing the interest charged to borrowers on new loans. Interest charges on loans to students could be raised by increasing the interest rate charged after they leave school, or by requiring that loans to all students accrue interest while the students are in school or in the six-month grace period after they leave. Interest charges on loans to parents could also be raised.

Raise the Loan Origination Fee by 1 Percentage Point. Raising the origination fee on loans by 1 percentage point would reduce federal subsidies by a total of $1.5 billion during the next five years. It would, however, reduce the subsidies to borrowers, including

those with the fewest financial resources. An alternative, which would exempt many lower-income borrowers, would raise the fee only in the unsubsidized program. That version would, however, limit the savings to $645 million over the 1998-2002 period.

Charge All Student Borrowers Interest While They Are Attending School or During the Six-Month Grace Period. Another option would be to require that loans to all borrowers in the subsidized program accrue interest from the time the students borrow, as is now the case in the unsubsidized program. Doing so would eliminate the difference between subsidized and unsubsidized loans. Charging interest on all new loans while borrowers were in school, but deferring actual payments until after they left, would reduce federal outlays by $13.0 billion between 1998 and 2002.

A variation of this option that would reduce but not eliminate the subsidy given to lower-income borrowers would require all loans to begin accruing interest immediately after the students left school, thereby eliminating the current six-month grace period for subsidized borrowers. Under this option, borrowers would continue to be allowed a period of six months before the first payment was due. That approach would save about $2.2 billion over the 1998-2002 period.

These measures would not cause cash flow problems for students while they were in school because they would be allowed to defer interest payments during that period. Since the added costs would generally occur only after leaving school--when borrowers would be better able to afford them--most students would still be able to continue their education. By concentrating the reductions on the subsidized loan program, however, these options would have the greatest impact on lower-income borrowers.

Raise Interest Rates on Student Loans After the Six-Month Grace Period. Federal subsidies could also be reduced by raising the interest rate charged on loans to students after the six-month grace period. Currently, the rate is a variable one (tied to the cost of borrowing by the federal government) with a fixed maximum. Raising the interest rate and the interest rate cap on all new loans by 0.5 percentage points would reduce federal spending by $2.0 billion during the 1998-2002 period.

An advantage of this option is that it would raise the cost of the program to borrowers after they left school, when they could better afford it. It would also lower federal costs significantly and continue to provide economic subsidies to borrowers in the subsidized program. The larger payments that would result from this change might, however, cause some students (especially needy students) to limit their choices to lower-priced institutions or possibly not to attend school. (Reflecting the available evidence, however, these estimates assume that all borrowers would continue to attend postsecondary schools and would continue to borrow the same amounts).

As with raising the loan origination fee, this option could be applied only to borrowers in the unsubsidized loan program. Doing so would generally limit the effect of the change to students from families with greater financial resources and to parents, but it would also lower the savings to $805 million between 1998 and 2002.

Raise Interest Rates on Loans to Parents by 1 Percentage Point. Federal outlays could be reduced by raising the interest rate and the interest cap on all new loans to parents by 1 percentage point. This option would reduce federal outlays by $835 million between 1998 and 2002 and continue to provide economic subsidies for many parents. Again, the larger payments that would result from this change might cause some students (particularly those from lower-income families) to limit their choices of schools or to forgo further education entirely.

ENT-21 RAISE THE COST OF THE STUDENT LOAN PROGRAM TO LENDERS, GUARANTY AGENCIES, AND SCHOOLS

Savings from Current-Law Spending	Annual Savings (Millions of dollars) 1998	1999	2000	2001	2002	Five-Year Cumulative Total
Raise the Lender Origination Fee						
Outlays	55	75	80	85	90	425
Lower the Default Reimbursement Rates						
Outlays	25	40	45	45	50	205
Eliminate the Fee Paid to Loan Originators						
Outlays	30	50	50	55	55	240

The Higher Education Amendments of 1992 created two programs providing loans for students to attend postsecondary schools: the Federal Family Education Loan Program (FFELP) and the Federal Direct Loan Program. Under FFELP, banks provide the capital for the loans. State and private nonprofit guaranty agencies insure lenders against losses that arise if students default on their loans. In turn, those agencies are reinsured by the federal government. In the direct loan program, the federal government provides the loans directly to students through their schools.

The government recoups part of the cost of FFELP by collecting 0.5 percent of the face value of each loan from lenders as an origination fee. In addition, the government recoups part of the cost of defaults from guaranty agencies. Until their default rates exceed 5 percent, guaranty agencies are reimbursed for 98 percent of the value of their defaulted loans. After that point, an agency is reimbursed for only 88 percent of the value of defaulted loans for the remainder of the fiscal year. If the claims exceed 9 percent, the reimbursement rate falls to 78 percent.

Raise the Lender Origination Fee. Raising the lender origination fee from 0.5 percent to 1 percent would reduce the federal costs of FFELP by a total of $425 million between 1998 and 2002. The rise in the origination fee might, however, reduce the number of lenders willing to participate in the program if some of them found that doing so was no longer profitable. Such a change might require that students spend more time finding a lender.

Lower the Default Reimbursement Rates. Lowering the default reimbursement rates to guaranty agencies by 3 percentage points (from 98 percent to 95 percent, for example) would reduce federal outlays for FFELP by $205 million over the next five years. Doing so might encourage guaranty agencies to be more diligent in ensuring that loans do not enter default. It would, however, increase the cost of the program to some agencies, which often have no choice in insuring loans that are at high risk of default.

Eliminate the Fee Paid to Loan Originators. Postsecondary schools that participate in the direct loan program receive a $10 fee for each borrower to help defray the cost of administering the program. In many cases, alternate originators, not schools, originate the loans and are paid a fee. Federal outlays could be reduced by an estimated $240 million over the 1998-2002 period if this fee was eliminated. Schools voluntarily participate in the direct loan program, and eliminating the payment would probably not cause many of them to return to FFELP. Faced with the loss of revenue, however, some schools might increase their tuition or reduce their services, having an unintended negative effect on students.

ENT-22 REDUCE STUDENT LOAN SPENDING BY INCLUDING HOME EQUITY IN THE DETERMINATION OF FINANCIAL NEED AND MODIFYING THE SIMPLIFIED NEEDS TEST

Savings from Current-Law Spending	Annual Savings (Millions of dollars)					Five-Year Cumulative Total
	1998	1999	2000	2001	2002	
Outlays	80	115	115	115	120	545

The Higher Education Amendments of 1992 eliminated house and farm assets from consideration in determining a family's ability to pay for postsecondary education, thereby making it easier for many students to obtain subsidized student loans. The legislation specifies formulas for calculating a family's need for subsidized loans. The amount a family is expected to contribute is determined by what is essentially a progressive tax formula. In effect, need analysis "taxes" family incomes and assets above amounts assumed to be required for a basic standard of living. The definition of assets excludes house and farm equity for all families, and all assets for applicants whose income is below $50,000.

Under this option, house and farm equity would be included in the calculation of a family's need for financial aid for postsecondary education. In addition, the income threshold under which most families are not asked to report their assets would be lowered to its previous level of $15,000. House and farm equity would be "taxed" at rates up to about 5.6 percent after a deduction for allowable assets.

Outlays could be reduced by about $545 million during the 1998-2002 period by including house and farm equity and modifying the simplified needs test. Associated savings could also be achieved in the Pell Grant program, a discretionary program that provides grants to low-income students. Outlays in that program could be reduced from the 1997 funding level adjusted for inflation by about $30 million in 1997.

Not counting home equity gives families who own a house an advantage over those who do not. There is concern, however, that because increases in incomes have not always kept pace with increases in housing prices, some families might have difficulty repaying their mortgage if they borrow against home equity to finance their children's education. In addition, having to value their home and other assets would complicate the application process for many families.

ENT-23 INCREASE USER FEES ON PRODUCTS REGULATED BY THE FDA

	Annual Added Receipts (Millions of dollars)					Five-Year Cumulative Total
	1998	1999	2000	2001	2002	
Addition to Current-Law Receipts	145	149	154	158	163	769

Under the Prescription Drug User Fee Act of 1992, the Food and Drug Administration (FDA) is authorized to collect fees from pharmaceutical manufacturers to help cover the cost of reviewing new drug applications. Those fees are scheduled to expire at the end of fiscal year 1997. Reauthorizing those fees at current levels adjusted for inflation and establishing user fees for medical devices and other products regulated by the FDA could increase revenues by $145 million in 1998 and $769 million through 2002. The Administration's budget request proposes to increase the user fees collected by the FDA to $244 million in fiscal year 1998. That would constitute an increase of approximately $90 million above the levels proposed here.

The FDA's regulatory activities benefit both consumers and industry. The primary function of the agency is to ensure public safety by monitoring the quality of pharmaceutical products, medical devices, and food. Firms benefit from the public confidence that results from the FDA's quality standards. Ensuring a high level of product quality is essential to the success of those industries. Proponents of establishing new user fees argue that since firms benefit from those regulatory services, they should bear a share of the costs.

The Prescription Drug User Fee Act of 1992 established application fees and set a projected revenue schedule. The FDA charges a fee of $205,000 for each new drug application. Each supplemental application costs $102,500. In addition, pharmaceutical firms that have had a new drug application pending with the FDA at any time since September 1992 must pay an annual fee of $115,700 per manufacturing establishment and $13,200 per product on the market. In 1997, those fees are expected to raise $88 million, covering about 24 percent of the FDA's expenditures on regulating prescription drugs. Reauthorization of the Prescription Drug User Fee Act of 1992, assuming fees were set at 1997 levels adjusted for inflation, would produce $91 million in revenues in 1998 and $481 million between 1998 and 2002. If, in addition to reauthorization, those fees were increased by 40 percent above 1997 levels (after adjusting for inflation), they would produce an additional $36 million in revenues in 1998 and $192 million between 1998 and 2002.

The Federal Food, Drug, and Cosmetic Act requires that firms register all new medical devices before they are marketed and obtain FDA approval for certain types of devices (class III). Currently, manufacturers of medical devices do not pay fees to the FDA. Legislation proposed in 1994 included submission fees for the approval and registration of new medical devices that would have raised $24 million, but the Congress did not pass it. Application fees of $60,000 for each new medical device needing premarket approval would raise $3 million in 1998. Fees of $6,000 for new product registration (premarket notification) would raise $33 million in 1998. Combined, those fees would cover about 23 percent of the costs of regulating the medical device industry. If the new fees were used to increase FDA expenditures, they would not reduce the deficit. Industry would be likely to agree to new application fees and fee increases if the raises were accompanied by promises to speed up the approval process, but that could increase FDA expenditures.

Finally, the food industry could be charged user fees that would raise $19 million in 1998, covering about 8 percent of the FDA's costs of regulating the industry. The agency inspects domestic food processors, analyzes more than 17,000 domestic food samples a year, and monitors the quality of seafood. If the FDA charged domestic food processors employing more than 250 people and processing all foods except meat and poultry an annual fee of $10,000, it could raise $10 million. If the Food and Drug Administration also

charged each domestic establishment employing 100 to 249 people an annual fee of $5,000, it could raise another $9 million.

Charging user fees to all domestic food processors would be cumbersome. There are more than 15,000 domestic food processors who employ fewer than 100 people. Smaller establishments have a much lower sales volume and therefore should be charged a much lower annual fee. Collecting a low fee from so many establishments, however, might be counterproductive.

In general, people opposing FDA user fees might argue that the agency's current oversight activities are excessive. Rather than increasing user fees, the FDA could cut costs by scaling back its regulatory requirements.

ENT-24 REDUCE THE 50 PERCENT FLOOR ON THE FEDERAL SHARE OF FOSTER CARE AND ADOPTION ASSISTANCE PAYMENTS

Savings from Current-Law Spending	Annual Savings (Millions of dollars) 1998	1999	2000	2001	2002	Five-Year Cumulative Total
Foster Care and Adoption Assistance Outlays	90	120	140	150	160	660

The Foster Care and Adoption Assistance programs provide benefits and services to children who are in need.

The federal government and the states jointly pay for the Foster Care and Adoption Assistance programs. The federal share of the costs of the programs varies with a state's per capita income. High-income states pay for a larger share of benefits than do low-income states. By law, the federal share can be no less than 50 percent and no more than 83 percent. The 50 percent federal floor currently applies to 12 jurisdictions: Alaska, Connecticut, Delaware, the District of Columbia, Hawaii, Illinois, Maryland, Massachusetts, Nevada, New Hampshire, New Jersey, and New York.

Under this option, the 50 percent floor would be reduced to 45 percent, generating savings of about $90 million in 1998 and $660 million through 2002. The estimates assume, however, that states would partially offset their higher costs by reducing benefits.

Proponents of the change argue that high-income states that choose to be generous should bear a larger share of the cost. If the floor was reduced to 45 percent, federal contribution levels would be more directly related to the state's income, and seven of the 12 jurisdictions would still be paying less than the formula alone would require.

Opponents of the change stress that the higher incomes and benefit levels in the affected states partly reflect higher costs of living. If this proposal was adopted, the affected states would have to compensate for the lost federal grants by reducing Foster Care and Adoption Assistance benefits, lowering spending on other services, or raising taxes. If states chose to compensate by partially reducing benefits, as the estimates assume, beneficiaries of the program would be adversely affected.

ENT-25 REDUCE MATCHING RATES FOR ADMINISTRATIVE COSTS IN THE FOSTER CARE AND ADOPTION ASSISTANCE PROGRAMS

Savings from Current-Law Spending	Annual Savings (Millions of dollars) 1998	1999	2000	2001	2002	Five-Year Cumulative Total
Reduce Matching Rates to 50 Percent						
Budget Authority	95	105	110	120	130	560
Outlays	80	100	110	120	125	535
Reduce Matching Rates to 45 Percent						
Budget Authority	270	290	310	330	350	1,550
Outlays	220	280	300	330	350	1,480

The federal government pays one-half of most administrative costs for the Foster Care and Adoption Assistance programs; state and local governments pay the remaining share. Higher matching rates have been set for some types of expenses as an inducement for local administrators to undertake more of some activities than they would if those expenses were matched at 50 percent. For example, training costs are matched at 75 percent.

Reducing the higher matching rates to 50 percent would decrease federal outlays by $80 million in 1998 and by $535 million over the 1998-2002 period. Considerably greater savings would be generated if all the matching rates for administrative costs were reduced to 45 percent, because an additional 5 percent of the total administrative expenses would be shifted to the states. Federal outlays would fall by $220 million in 1998 and by $1.5 billion over the 1998-2002 period.

Reducing the higher matching rates to 50 percent would be appropriate if the need to provide special incentives for activities such as training no longer exists. Reducing all matching rates to 45 percent would give states stronger incentives to reduce administrative inefficiencies because the states would be liable for a greater share of the associated cost.

States might respond to either option by reducing their administrative efforts, however, and might thereby raise program costs and offset some of the federal savings. Specifically, states might make less effort to eliminate waste and abuse in payments to providers. Conversely, this proposal might harm recipients by encouraging states to lower benefits or limit services provided under these programs in order to hold down total costs.

ENT-26 REDUCE FEDERAL EMPLOYEE RETIREMENT COSTS

Savings from Current-Law Spending	Annual Savings (Millions of dollars) 1998	1999	2000	2001	2002	Five-Year Cumulative Total
Defer COLAs for Retirees						
Military Retirement	280	680	1,100	1,540	2,000	5,600
Civilian Retirement	120	280	420	530	620	1,970
Limit Some COLAs Below Inflation						
Military Retirement	230	550	880	1,240	1,610	4,510
Civilian Retirement	160	370	600	830	1,080	3,040
Pay Full COLAs on Benefits Below a Certain Level and 50 Percent on Benefits Above That Level						
Military Retirement	210	520	860	1,210	1,580	4,380
Civilian Retirement	270	640	1,030	1,430	1,850	5,220
Modify the Pension Calculation						
Military Retirement	20	30	60	80	100	290
Civilian Retirement	10	50	100	150	210	520
Restrict the Agency Match on Thrift Savings Plan Contributions to 50 Percent						
Civilian Retirement[a]	390	590	670	750	850	3,250
Raise Employee Contributions						
Military Retirement[b]	10	70	110	140	180	510
Civilian Retirement[b]	690	1,630	1,900	1,940	1,990	8,150

a. Discretionary savings from the 1997 funding level adjusted for inflation.

b. Addition to current-law revenues.

Federal civilian and military retirement programs cover about 4.5 million active government employees. Federal pension payments to 4.2 million retirees and survivors totaled $68.6 billion in 1996. Practically speaking, there are three basic approaches to reducing the costs of federal retirement--namely, cutting benefits as they are earned by employees, cutting benefits as they are paid to retirees, or increasing employee contributions.

The Federal Employees' Retirement System (FERS) covers civilian employees hired since January 1984. FERS supplements Social Security, in which workers who are covered under FERS also participate. When the system was created, workers hired before 1984 had the option to join. Most civilian employees not in FERS are covered by the Civil Service Retirement System (CSRS). Employees who are covered under CSRS do not ordinarily participate in Social Security. Uniformed military personnel are covered by the Military Retirement System (MRS), which was last revised for personnel entering the service after July 31, 1986, and by Social Security.

The options described here for reducing the costs of federal retirement differ according to whom they would affect. The increase in contributions, for example, would affect current workers by requiring them to contribute more of their income toward future benefits. By contrast, the options limiting cost-of-living allowances (COLAs) would immediately affect current retirees. Under provisions of the Omnibus Budget Reconciliation Act of 1993 (OBRA-93) and subsequent revisions, COLA payments for civilian and military retirees were delayed for three months (until April 1996). The other options would affect both current employees and future retirees.

The five-year cash estimates for the cuts in benefits described here represent only a small portion of the long-run savings that would result from reducing federal retirement costs. One reason is that the options are phased in at different rates, so the first year's cash savings are relatively small. Even more important, the cash flows and costs are accounted for differently in different options. For example, the bulk of the cash savings from modifying the salary used to compute pensions shows up years or decades in the future, when current employees retire. By contrast, the option of raising employee contributions counts as an immediate savings. Given those differences, the relative size of savings over five years for each option may not be an accurate guide to the long-run advantage of each for reducing the budget. Moreover, the emphasis on five-year cash estimates makes options such as increasing the federal retirement age less attractive than they would be otherwise. Such an option, which was considered by the Bipartisan Commission on Entitlement and Tax Reform, can have a large payoff in the longer run but not over the next five years.

The main argument for cutting federal retirement costs is that benefits are more generous than those typically offered by firms in the private sector. Reducing selected federal retirement benefits and increasing pay would produce a mix of current and deferred compensation that was more in line with standards in the private sector. Even if federal retirement was reduced in the manner described below, many federal retirees would still receive benefits that exceed those typically afforded employees retiring from private firms. Depending on how they are designed, some of the cuts in benefits could also promote efforts to reduce employment without layoffs because some workers would leave before reductions took effect. That would be especially true if employees were offered cash as an added inducement to resign. Cuts in retirement, moreover, probably hurt retention and recruitment less than salary cuts. Employees are likely to be more responsive to a salary cut that lowers their current standard of living than to a cut in the rate at which retirement benefits are earned that lowers their future standard of living.

The main argument against cutting retirement benefits is that such an action hurts both retirees and the government's ability to recruit a quality workforce. Advocates for federal workers and retirees point out that pensions are part of the employment contract between the government and its employees; attempts to cut retirement benefits therefore constitute reneging on earned benefits. They also argue that, although certain provisions of retirement are generous, total compensation should be the basis of comparison between federal and private-sector employees. Annual surveys indicate that federal workers may be accepting salaries below private-sector rates for comparable jobs in exchange for better retirement benefits. In essence, those workers pay for their more generous retirement benefits by accepting lower wages during their working years. Moreover, as some observers maintain, cutting benefits that were promised to current annuitants may prompt forward-looking workers to demand higher pay now to offset the increased uncertainty of their deferred earnings.

One way to avoid some of the negative consequences of reductions in retirement benefits is to make such cuts apply only to new employees. Current employees could not argue that this prospective approach violates their labor contracts. The approach produces small savings in the short term but substantial savings in the future.

Options Offering Savings in the Near Term

Several of the options available for trimming federal retirement costs would produce savings in the near term. Those options involve cutting cost-of-living ad-

justments for retirees, changing formulas on which benefits are based, or increasing employee contributions.

Defer Cost-of-Living Adjustments

The CSRS and the prereform MRS (covering new recruits before August 1, 1986) provide full cost-of-living protection to all retirees, even those who retire before they are 62 years old. That kind of inflation protection is expensive when compared with what is available under the largest and most generous private pensions. Deferring COLAs until age 62 for all nondisabled employees who retired before that age would yield savings of $7.6 billion over five years. (Almost three-quarters of the estimated savings would derive from MRS because more than one-half of its annuitants are nondisabled retirees under 62, most of whom left the service in their 40s.) This COLA deferral would result in a loss of $8,600 over five years for a CSRS-covered annuitant retiring at 55 with an average annuity of $20,500 in 1998. The average military retiree under 62 years old would lose $11,600 over five years based on an average annuity of $19,600 in 1998.

If COLAs were deferred, the government's retirement costs would be moderated and more in line with the treatment of COLAs under FERS and the postreform MRS. (Consistent with the MRS reforms, this option allows a catch-up adjustment at age 62 that reflects inflation after the date of retirement. Most retirees under FERS receive neither protection before age 62 nor a catch-up at 62.) Although the option would lower the compensation of affected workers after retirement, many retirees should be able to supplement their pensions by working--as most military retirees already do. Opponents note that this policy is especially hard on military retirees, who are generally forced to retire after 20 to 30 years of service. As an alternative to eliminating COLAs, retirees who have not reached the age of 62 could be granted COLAs equal to one-half of the inflation rate with no catch-up provision. That option would offer retirees under 62 some immediate insurance against inflation. The plan parallels changes that the Congress mandated in 1982 but subsequently repealed. It would result in savings of about $3.9 billion over five years.

Limit Some COLAs

On average, private pension plans offset only about 30 percent of the erosion of purchasing power caused by inflation. By contrast, CSRS and the prereform MRS provide 100 percent automatic protection from inflation. However, some of that protection was temporarily taken away by delayed effective dates under OBRA-93. The General Accounting Office calculated that COLA delays and reductions during the 10-year period from 1985 through 1994 effectively reduced COLAs to about 80 percent of inflation.

This option would limit COLAs to 1 percentage point below the rate of inflation for the old MRS and to one-half point below inflation for CSRS. (The smaller half-point limitation for CSRS would apply to a more comprehensive benefit that, unlike the defined benefits under FERS and MRS, substitutes for both Social Security and employer-sponsored benefits. Therefore, the smaller cut would produce a reduction comparable to the one-point limit for MRS enrollees.) Those changes would conform to the postretirement COLAs for employees covered by FERS and the revised MRS. This option, however, would hurt low-income retirees most. It would also renege on an understanding that workers in CSRS who passed up the chance to switch systems would retain their full protection against inflation. Savings would amount to $7.6 billion through 2002. (Savings from this option would decrease to $5.1 billion if it was coupled with the preceding one that would defer COLAs until age 62.) The average CSRS-covered retiree would lose $1,500 over five years, and the average military retiree would lose $4,100 over five years.

Reduce COLAs to Middle- and High-Income Retirees

Another alternative would tie the COLA reductions to beneficiaries' payment levels. The example discussed here would award the full COLA only on the first $665 of a retiree's monthly payment and a half COLA on the remainder. The $665 per month threshold is about equal to the projected 1998 poverty level for an elderly person and would be indexed to maintain its value over time. Similar proposals have been considered for Social Security.

This approach would save about $480 million in 1998 and $9.6 billion over the 1998-2002 period. The average CSRS-covered retiree would lose $2,400 over five years, and the average military retiree would lose $3,300. Because the full COLA would be paid only to beneficiaries with low annuities, this option would better focus COLAs on retirees who have the greatest need for protection from inflation. Retirees receiving FERS benefits already receive a reduced COLA, so this change would affect them less than those receiving CSRS benefits. Pension benefit levels are not always good indicators of total income, however, so the restricted COLAs would not always be focused on low-income cases. Furthermore, many people object to any changes in earned retirement benefits that might be construed as introducing a means test for benefits, even if the test is limited only to the COLA. They also point out that federal pensions are fully taxable under the federal individual income tax in the same proportion that they exceed the contributions that employees made during their working years.

Modify the Salary Used to Set Pensions

Under current law, CSRS and FERS provide initial benefits based on an average of the employee's three highest-salaried years. MRS also uses that three-year base for personnel hired after September 1980. However, personnel hired before that date will receive benefits calculated using salary at the date of retirement. If, instead, a four-year average was adopted for CSRS and FERS, as well as for military personal hired after September 1980, and a 12-month average was adopted for the remaining military personnel, initial pensions would be about 2 percent to 3 percent smaller for most new civilian retirees and about 1 percent to 2 percent smaller for military retirees. Total savings to the government through 2002 would be $810 million.

This option would align federal practice more closely with practice in the private sector, where five-year averages are common. In the long run, this option could encourage some employees to stay on another year in order to take full advantage, when calculating retirement benefits, of the higher salaries that may occur over time. That could help the government keep experienced people, but hinder efforts to reduce federal employment. In 1995, the Congress actively considered the 12-month final pay option for military personnel, but ultimately rejected that proposal. About 250,000 personnel would have been affected.

Restrict Matching Contributions

The Thrift Savings Plan (TSP) is a defined contribution plan similar to 401(k) plans that many private employers offer. Federal agencies automatically contribute 1 percent of individual earnings to the TSP on behalf of any worker covered by FERS. In addition, the employing agency matches voluntary employee deposits dollar for dollar for the first 3 percent of pay and 50 cents for each dollar for the next 2 percent of salary. The entire federal contribution for employees putting aside 5 percent amounts to a sum equal to 5 percent of pay. If the government limited its matching contributions to a uniform 50 percent rate against the first 5 percent of pay, the government's maximum contribution would fall to 3.5 percent of pay. Compared with current law, the discretionary savings from this proposal would total $3.3 billion over five years. (The estimates exclude savings realized by the Postal Service because it is now off-budget and reductions in its operating costs eventually benefit only mail users.) Assuming continuation of the automatic 1 percent match, this arrangement would remain superior to the coverage typically offered in the private sector.

Restricting the matching contributions would have several drawbacks. Middle- and upper-income employees rely on the government's matching contributions to maintain their standard of living during retirement because Social Security replaces a smaller fraction of their income than it does for lower-income employees. Part of the TSP's appeal derives from the fact that it provides individual accounts for each participant, the value of which cannot be cut by subsequent changes in law. The security and portability of the TSP were a major reason for the decision of many employees to switch to FERS, because the TSP compensated for an inferior defined benefit plan. Changing the TSP's provisions would be especially unfair to that group, whose decision to switch plans reasonably assumed that changes would not be made. Opponents of restricting the matching rate also argue that doing so would diminish employees' savings for retirement, and that problem would be intensified if the cut reduced participation.

Increase Employee Contributions for Federal Pensions

As an alternative to cutting benefits, the government could increase its revenues by raising civilian and new military employees' contributions. The strength of the federal retirement system lies in the indexed benefits that provide inflation protection that cannot be purchased in the private sector. Requiring employees to contribute to their retirement funds--an uncommon practice in the private sector--is one way of offsetting that extra cost while maintaining a high level of salary replacement.

On the downside, for most federal civilian employees and new entrants to military service, the option would be equivalent to a 2 percent pay cut without a drop in taxes. It would increase the relative importance of deferred compensation, which some critics argue costs the government more than the value employees place on it. In addition, it would threaten the government's ability to recruit new workers and to retain experienced personnel. Finally, the option would further distance the federal government from common private-sector compensation practices. According to recent survey data, only about 13 percent of private pension plans require additional employee contributions. But private-sector employees contribute 6.2 percent of their pay (up to $65,400 in 1997) for Social Security.

Increasing Contributions from Civilian Employees. For civilian employees, this option would increase both CSRS- and FERS-covered employees' contribution rates by 1 percentage point in January 1998 and by another point a year later. It would generate revenue of about $8.2 billion through 2002. Currently, workers covered by CSRS contribute 7 percent of their salary to their retirement fund, but they pay no Social Security taxes. The 0.8 percent contribution rate for FERS-covered employees, together with their 6.2 percent share of the Social Security tax, was set to equal the employee contribution in CSRS.

An alternative to this option would be to restrict the increased employee contributions to CSRS-covered workers. That alternative would raise $3.8 billion in revenue over five years. Currently, the employee's 7 percent contribution and the employing agency's matching 7 percent contribution cover just 56 percent of the cost of CSRS pension benefits as earned. The Office of Personnel Management estimates that full funding of CSRS pension benefits would require contributions totaling 25.14 percent of payroll. Over time, the government makes additional payments that cover most of the remaining unfunded benefits. Raising the CSRS contribution rate to 9 percent over two years would lessen this "shortfall." Alternatively, the CSRS shortfall could be funded through higher agency contributions, although that would not reduce the long-term cost to taxpayers. Higher agency contributions would confront managers with the true cost of labor and could improve program management and resource allocation.

There is no funding shortfall for FERS participants. Restricting the higher contributions to CSRS-covered employees, however, would lower their take-home pay in relation to similarly situated FERS-covered employees, which would penalize workers who chose to stay in CSRS in 1987 rather than join the new FERS. More CSRS-covered employees would have switched to FERS when they had the opportunity if they had known that their contribution rate would increase.

Increasing Contributions from Military Personnel. This option would also require people entering military service to contribute a portion of their basic pay toward their future retirement costs. Currently, military personnel do not contribute to their retirement, although they do pay Social Security. Entering service members would contribute 1 percent of their basic pay in January 1997, and that rate would rise by another percent a year later. Because military personnel who leave with less than 20 years' service time receive no pension, they would receive a refund of the full amount of their contributions with interest. Adopting this plan would save $10 million in 1998 and a total of $510 million through 2002. Because of future refunds, those amounts overstate the eventual savings by $320 million during the period. In 20 years, when the transition for this proposal was complete, annual savings would total nearly $790 million.

Military retirement benefits are significantly more generous than federal civilian retirement benefits. Requiring contributions by military personnel would be a step toward putting their system on an equal footing with its civilian counterpart. Proponents argue that equity is an important consideration--current and deferred compensation are important for recruiting and retaining civilian as well as military personnel--that has played a

role in other actions such as advancing COLAs for military retirees to the same dates as COLAs for civilian retirees. Further, advocates contend that requiring new personnel to contribute 2 percent of basic pay would have little impact on recruitment and retention. Reforms during the 1980s that cut military retirement benefits by 25 percent appear to have had only a negligible impact on meeting such goals, although their effect is difficult to assess because of other personnel policies that the military services have carried out in connection with the overall defense drawdown.

The military retirement system, however, is supposed to support a personnel system very different from those in civilian organizations. Although many military occupations at all levels closely resemble civilian jobs, the services assert a need for a "young and vigorous" force and thus support their retirement system that allows members to leave at still youthful ages after 20 years of service without imposing financial hardships. Further, the system encourages trained, skilled personnel who have 12 to 20 years of experience to remain in the service instead of seeking alternative employment. Opponents argue that the option would hurt retention by increasing the incentive for members to leave the military before they became eligible for retirement, especially because it offers an "exit bonus" in the form of the return of contributions. They contend that a direct pay cut, or a reduced pay raise in one year, could yield equal savings at lesser cost to retention. Critics of the option claim that offsetting its negative effects would require higher pay or larger reenlistment bonuses that could more than wipe out projected savings.

Options with Long-Term Impacts

The Congress has several additional options that could cut retirement spending in the long term but would not result in significant near-term cash savings. The Congress should evaluate those options, not only in terms of their savings but also in light of their effects on the ability of the government to recruit and retain a skilled workforce and the credibility of the federal government as a reliable employer. In presenting these options, the Congressional Budget Office does not mean to suggest that any of the retirement programs face a financial crisis. In contrast to Social Security, the ratio of beneficiaries to the revenue base in those programs does not surge. In fact, the demand placed on the general fund by civil service retirees is expected to decline in constant dollar terms after 2015, according to the Office of Personnel Management's projections.

Raise the Retirement Age

The federal system generally permits retirement earlier than does the private sector. Most civilian federal employees can retire with immediate unreduced benefits at age 55 with 30 years of service, at 60 with 20 years of service and at 62 with five years of service. The minimum retirement age gradually rises to 57 for FERS employees born after 1969. As life expectancies have increased, Social Security and other retirement plans have raised retirement ages.

This option would gradually raise the normal retirement age for receiving CSRS and FERS benefits from 55 to 57. Starting with employees who are currently 35 years old, the retirement age would increase by two months each year. Voluntarily retirement would still be allowed at age 55 with actuarially reduced benefits. For illustrative purposes, if the current retirement age were 57 instead of 55, about 15,000 employees each year would have to delay their retirement one to two years, thus saving about $600 million a year in 1998 dollars. The federal government could realize even greater savings if the retirement age was gradually increased to 60. Starting with employees under age 33, the retirement age for unreduced benefits would increase by four months each year until it reached 60.

The majority of federal employees would not be affected by this option. Recently, only 34 percent of the workforce voluntarily retired before age 60. Also, 47 percent of those retiring under normal retirement rules in 1996 were 62 or older. Nevertheless, raising the retirement age would still reduce federal retirement costs substantially. Most savings, however, would occur far beyond the five-year period identified in this option because it would be necessary to phase in such a reform over several years.

Raising the retirement age, however, disrupts the long-term financial planning of employees, and is especially unfair to those near retirement already. In addi-

tion, the option would lengthen the service requirements for those employees who tend to have the longest federal service. Further, any tinkering with the retirement system may increase employees' uncertainty about the future of the system and weaken their attraction to government service.

Reduce the Rate at Which Benefits Are Earned

The rates at which employees earn or accrue benefits determine the percentage of salary base--currently the three highest-paid years--that workers earn in pension benefits for each year of service. This option would reduce the accrual rates by 0.1 percentage point for each year of service after January 1, 2000. (If a worker valued retirement benefit accruals and wages equally, he or she would view the cut as similar to a reduction of $100 in pay for each $10,000 earned.) Thus, workers would see their replacement rate drop by 1 percentage point for each 10 years of service after 2000. For example, FERS employees who retired after 30 years of service would see the defined benefit portion of their pension fall by 10 percent--from 30 percent of final salary to 27 percent of salary.

Reducing the defined benefit portion of retirement lessens the extent to which retirement benefits bind the employee to federal service. Currently, workers who leave government service before normal retirement age effectively lose much of their expected pension wealth. This option would reduce that loss and thus probably lead to greater turnover among experienced and highly trained federal employees, who might find midcareer moves to the private sector more attractive.

Some analysts have also suggested that the Congress reduce the rate at which military personnel earn retirement benefits after 20 years of service. One common proposal is to reduce the rate at which such benefits are earned from 3.5 percent a year to 2 percent a year. Benefits would still accrue at 2 percent of active-duty pay for the first 20 years of service. That reduction in earned benefits would reduce pensions from 75 percent of active-duty pay after 30 years of service to just 60 percent of pay, a 20 percent reduction. That proposal would only cover new personnel.

That proposal, however, would greatly reduce the incentive to stay in the service past 20 years. In fact, the pension benefit formula was last reformed in 1986 with the express purpose of assisting retention beyond 20 years of service. Further, although 30-year retirees would still be receiving a pension that replaced 60 percent of active-duty pay, only 45 percent of regular compensation would be replaced. In addition to basic pay, regular military compensation includes housing and subsistence allowances.

Increase Reliance on the TSP

The Thrift Savings Plan has proven very popular with employees for several reasons. First, the benefits are portable, which allows mobility. Vested individuals who switch jobs suffer no loss of pension wealth. Second, the accounts are safe from political tampering. The Congress cannot reduce the benefits that employees have already earned. Third, individuals who are willing to assume greater risks have the potential to earn much higher returns than are available from investments in Treasury securities. For example, last year the return on the government bond fund was 7 percent, but the passively managed stock-indexed fund earned 23 percent. Although those high returns in the stock fund are atypical--the 1994 return was just over 1 percent--and significant losses can occur if the market collapses, employees who invest in the stock fund can expect higher returns over time, based on past experience.

The experience to date with the TSP suggests that a possible win-win situation exists--savings for the government and higher-valued retirement benefits for federal employees--if the government increases its reliance on the TSP. Because of the potential for higher returns on TSP investments and the plan's other positive attributes, the average employee might be better off if the government devoted more of its resources to TSP contributions and less to defined benefits. For example, employees might find a $90 contribution to the TSP more attractive than $100 in defined benefit promises.

Although long-term savings might be realized, the short-term effects would be much higher cash outlays. The government's contributions to the TSP show up in

the budget as cash outlays immediately, whereas the defined benefits that are earned by employees result in budget outlays only when they are paid out years later.

Increasing reliance on the TSP raises a number of additional issues. First, individuals bear the full investment risk in the Thrift Savings Plan, whereas they bear none under defined benefit plans. Second, TSP offers no disability benefits and cannot be easily modified to subsidize early retirement and encourage downsizing. Third, the government cannot easily use the TSP to bind employees to the federal sector.

ENT-27 END OR SCALE BACK TRADE ADJUSTMENT ASSISTANCE

Savings from Current-Law Spending	Annual Savings (Millions of dollars) 1998	1999	2000	2001	2002	Five-Year Cumulative Total
End Trade Adjustment Assistance						
Budget Authority	215	315	330	330	335	1,525
Outlays	155	300	330	330	335	1,450
Eliminate Trade Adjustment Assistance Cash Benefits						
Budget Authority	115	220	235	235	235	1,040
Outlays	115	220	235	235	235	1,040

The Trade Adjustment Assistance (TAA) program offers income-replacement benefits, training, and related services to workers unemployed as a result of import competition. To obtain assistance, such workers must petition the Secretary of Labor for certification and then meet other eligibility requirements. Cash benefits are available to certified workers receiving training, but only after their unemployment insurance benefits are exhausted.

Ending the TAA program would reduce federal outlays by $155 million in 1998 and by $1.4 billion during the 1998-2002 period. Affected workers could apply for benefits under title III of the Job Training Partnership Act (JTPA), which authorizes a broad range of employment and training services for displaced workers regardless of the cause of their job loss. Because funding for title III is limited, however, TAA cash benefits alone could be eliminated, and the remaining TAA funds for training and related services could be shifted to title III. Savings under that option would total $1.0 billion during the 1998-2002 period.

The rationale for these options is to secure under federal programs more equivalent treatment of workers who are permanently displaced as a result of changing economic conditions. Since title III of JTPA provides cash benefits only under limited circumstances, workers who lose jobs because of foreign competition are now treated more generously than workers who are displaced for other reasons.

Eliminating TAA cash benefits would, however, cause economic hardship for some of the long-term unemployed who would have received them. In addition, TAA now compensates some of the workers adversely affected by changes in trade policy. Some people argue, therefore, that eliminating TAA benefits could lessen political support for free trade, which economists generally view as beneficial to the overall economy.

ENT-28 REDUCE THE $20 EXCLUSION FROM INCOME IN SUPPLEMENTAL SECURITY INCOME

Savings from Current-Law Spending	Annual Savings (Millions of dollars)					Five-Year Cumulative Total
	1998	1999	2000	2001	2002	
Budget Authority	110	150	165	145	160	730
Outlays	110	150	165	145	160	730

The Supplemental Security Income (SSI) program provides federally funded monthly cash payments--based on uniform, nationwide eligibility rules--to needy aged, blind, or severely disabled people. In addition, all but seven states and jurisdictions provide supplemental payments. Because SSI is a means-tested program, its benefits are reduced by recipients' outside income, subject to certain exclusions. For unearned income--most of which is Social Security--the first $20 a month is excluded and any additional amounts reduce benefits dollar for dollar. Earned income is excluded more liberally, and any of the $20 exclusion that is not applied to unearned income is applied to earned income.

Reducing the monthly $20 exclusion to $15 would save $110 million in 1998 and $730 million over the 1998-2002 period. A program that ensures a minimum living standard for its recipients need not provide a higher standard for people who happen to have unearned income, as illustrated by the absence of any standard exclusion for unearned income (other than child support) in the Aid to Families with Dependent Children program.

Nevertheless, reducing the monthly $20 exclusion by $5 would decrease by as much as $60 a year the incomes of the roughly 2.5 million low-income people--approximately 40 percent of all federal SSI recipients--who will benefit from the exclusion in 1998. Even with the full $20 exclusion, incomes of most SSI recipients fall below the poverty threshold.

ENT-29 CREATE A SLIDING SCALE FOR CHILDREN'S SSI BENEFITS BASED ON THE NUMBER OF RECIPIENTS IN A FAMILY

Savings from Current-Law Spending	Annual Savings (Millions of dollars)					Five-Year Cumulative Total
	1998	1999	2000	2001	2002	
Budget Authority	0	85	130	115	135	465
Outlays	0	85	130	115	135	465

The Supplemental Security Income (SSI) program, administered by the Social Security Administration (SSA), provides cash benefits to elderly and disabled people with low incomes and qualifies them for Medicaid coverage. In addition, most states provide supplemental payments to SSI recipients. In recent years, the number of disabled children receiving SSI benefits has grown sharply, from almost 300,000 in 1989 to about 1 million in 1996. Children received approximately $5 billion in federal SSI benefits in 1996, accounting for almost one-quarter of federal SSI benefits paid that year to disabled recipients.

The increasing participation of children in the SSI program for the disabled stems in part from the Supreme Court's decision in *Sullivan v. Zebley* in 1990. That case broadened the eligibility rules for disabled children and led to a significant effort by SSA to inform possible beneficiaries of their potential eligibility for the program. In the Personal Responsibility and Work Opportunity Reconciliation Act of 1996, the Congress tightened the definition of disability for children, largely restoring a pre-Zebley standard. Nevertheless, the program is expected to begin growing again after the cuts required by the welfare reform law are fully carried out in 1998.

Unlike that in other means-tested programs, the amount of SSI benefits that a family receives for each additional member who qualifies does not decline as more family members participate in the program. For example, a family with one child qualifying for SSI benefits could receive up to $484 a month in 1996, or more than $5,700 a year, if the family's income (not including the SSI benefits received) was under the cap entitling them to the maximum benefit. If the family had a second child qualifying for benefits, it could have received an additional $484 a month for that child. The amount of benefits children receive is based only on the presence of a disability and the family's resources, not on the nature or severity of the qualifying disability.

This option would create a sliding scale for SSI disability benefits, so that a family would receive lower benefits per child as the number of children in the family qualifying for benefits increased. The sliding scale used for this option was recommended by the National Commission on Childhood Disability in 1995. It would keep the maximum benefit for one child receiving benefits as it is in current law, but further benefits would be reduced for each additional child in the family participating in the program. For example, if such a sliding scale were in place in 1997, the first child in a family qualifying for the maximum benefit would receive $484. The second child in such a family would receive $302, and the third would receive $257. Benefits would continue to decrease for additional children, but very few families have more than three children receiving SSI benefits. As with current SSI benefits, the sliding scale would be adjusted each year on the basis of the consumer price index.

SSA does not maintain data on multiple recipients of SSI in a household, and this option would be fairly laborious for the agency to carry out. Therefore, the Congressional Budget Office assumes that the new sliding scale would become effective in January 1999. About 90 percent of child recipients would be unaffected by the proposal, and the remaining 10 percent would have their benefits reduced by an average of about one-quarter. Altering the structure of SSI benefits in that manner would save $85 million in 1999. Over the 1999-2002 period it would save a total of $465 million.

Proponents of this option note that benefits awarded according to the proposed gradation take into account the economies of scale that are involved in raising more than one child. Since the amount of benefits that children obtain is not related to the severity of the disability, proponents argue that the benefits a family with several disabled children receives are greater than what is needed. The extra medical costs that disabled children might incur, which are not subject to economies of scale, would be covered by Medicaid as they are under current law.

Opponents of this measure argue that children with disabilities sometimes have additional expenses unique to their particular problems that may not be affected by economies of scale. Some of those costs are associated with various forms of therapy, modifications to housing facilities, and specialized equipment. If those additional costs were not covered by Medicaid, reducing cash benefits might adversely affect such families in a way that would not exist if the SSI program continued to use its current income test.

ENT-30 REDUCE THE FEDERAL MATCHING RATE AND INCREASE FEES IN THE CHILD SUPPORT ENFORCEMENT PROGRAM

Savings from Current-Law Spending	Annual Savings (Millions of dollars)					Five-Year Cumulative Total
	1998	1999	2000	2001	2002	
Reduce the Federal Matching Rate						
Budget Authority	700	760	840	920	990	4,210
Outlays	700	760	840	920	990	4,210
Charge Fees for Services						
Budget Authority	310	340	380	410	450	1,890
Outlays	310	340	380	410	450	1,890

NOTE: These estimates do not take into consideration the interaction between the two options, which is noted in the discussion.

Enacted in 1975, the Child Support Enforcement (CSE) program provides administrative tools and funding that states can use to improve the payment of child support by absent parents. The federal government helps states finance their CSE efforts by paying 66 percent of the costs and making incentive payments. As a result of that federal funding and because states keep a portion of child support collections, states saved $400 million in 1995. By contrast, the federal government incurred costs of about $1.3 billion in 1995, after accounting for the share of child support collections that is allotted for reducing welfare payments.

Reduce the Federal Matching Rate. The Congressional Budget Office estimates that lowering the federal matching rate from 66 percent to 50 percent in 1997 and subsequent years would save $700 million in 1998 and $4.2 billion through 2002, although the amount of savings could vary, depending on how states reacted to the change. Under CBO's assumptions, states would experience net costs in 2001 and thereafter.

Reducing the federal share of CSE costs would alter the balance of costs and savings between the federal and state governments, decreasing both federal costs and state savings. Although a higher matching rate may have been needed in the past to induce states to set up CSE programs, such programs are now operating and cannot be dismantled without financial penalty. Also, this option would encourage states to improve the efficiency of their CSE efforts, since they would pay a larger share of the costs of inefficiencies, and could thus produce even lower program costs.

Lowering the matching rate would entail some risks, however. Because caseloads for child support workers are already high, it is unlikely that states could improve efficiency enough to offset the reduction in federal payments. Thus, they might cut CSE services, thereby reducing child support collections.

Charge Fees to Some Families. Although states are required to charge application fees for furnishing child support services to families not receiving cash assistance through the Temporary Assistance to Needy Families (TANF) program, many states charge only nominal amounts. In 1995, child support enforcement agencies collected fees of about $35 million, or less than 2 percent of total program costs. This option would require states to charge non-TANF families a fee of $25 at the time they applied for services and a fee equal to 5 percent of any child support collected for them.

By charging these fees, the federal government would save $310 million in 1998 and $1.9 billion through 2002, at the current 66 percent federal matching rate. With a matching rate of 50 percent, as discussed above, savings would decline to $220 million in 1998 and $1.4 billion through 2002.

In view of the substantial services that many families receive from the CSE agencies, the fees would be a modest contribution toward meeting their costs. Charging fees could discourage some custodial parents from seeking assistance, however, potentially reducing collections of child support. For some families, the fees would be much higher than the cost of the services provided. The families most likely to be discouraged would probably be those most in need of the income, unless states chose to exempt low-income families from paying the fees.

ENT-31 REDUCE THE REPLACEMENT RATE WITHIN EACH BRACKET OF THE SOCIAL SECURITY BENEFIT FORMULA

Savings from Current-Law Spending	Annual Savings (Millions of dollars)					Five-Year Cumulative Total
	1998	1999	2000	2001	2002	
Outlays	190	750	1,620	2,680	3,580	8,820

Under current law, the basic Social Security benefit is determined by a formula that provides workers with 90 percent of their average indexed monthly earnings (AIME) up to the first bend point (which defines the first earnings bracket), plus 32 percent of the AIME in the second bracket, plus 15 percent of the AIME above the second bend point. One method of reducing initial Social Security benefits would be to lower those three rates by a uniform percentage.

Lowering the three rates in the benefit formula from 90, 32, and 15 percent to 87.3, 31.0, and 14.6 percent, respectively, would achieve an essentially uniform 3 percent reduction in the benefits of newly eligible workers, starting in 1998. Thus, a 62-year-old retiree who has always earned the average wage would receive initial benefits in 1998 of about 33 percent of preretirement earnings, compared with 34 percent if no change was made.

This reduction in the replacement rates would lower Social Security outlays by about $8.8 billion over the 1998-2002 period and by more in later years. Moreover, this option would reduce the benefits of all future retirees by essentially the same percentage. Furthermore, the option could be combined with a one-time cut in the cost-of-living adjustment to ensure that benefits for both current and future recipients would be reduced to a similar extent (see ENT-45). The combination would generate substantial budgetary savings and have a relatively small impact on both current and future beneficiaries.

Opponents contend that the Social Security Amendments of 1983 have already sharply reduced the benefits of future retirees and that further reductions would be unfair. In particular, the age at which unreduced Social Security retirement benefits are first available will rise in stages from 65 to 67 for workers turning 62 between 2000 and 2022. As a consequence, benefits for workers retiring after the turn of the century will be less than what would have been received had the full retirement age not been increased. For example, a worker who retires at age 62 in 2022 will receive 70 percent of the primary insurance amount, compared with 80 percent for a worker who retires at age 62 in 1997.

An alternative method of reducing Social Security benefits would leave replacement rates unchanged but narrow the AIME brackets over which those rates apply, perhaps by reducing the pace at which the brackets are indexed for inflation. That approach would exempt beneficiaries with the lowest AIME from the cut, but would impose benefit reductions unevenly among other recipients.

ENT-32 LENGTHEN THE SOCIAL SECURITY BENEFIT COMPUTATION PERIOD BY THREE YEARS

Savings from Current-Law Spending	Annual Savings (Millions of dollars)					Five-Year Cumulative Total
	1998	1999	2000	2001	2002	
Outlays	50	200	520	1,010	1,640	3,420

Social Security retirement benefits are based on the average indexed monthly earnings (AIME) of workers in jobs covered by the system. The present formula computes AIME based on workers' best 35 years of employment. Lengthening the averaging period would generally lower benefits slightly by requiring more years of lower earnings to be factored into the benefit computation. This option would increase the AIME computation period gradually until it reached 38 years for people turning 62 in 2000 or beyond. That approach would save $3.4 billion over the next five years and more in later years.

One argument for a longer computation period is that people are now living longer and the normal retirement age for the Social Security program will be raised beginning in 2000. In addition, lengthening the averaging period would reduce the advantage that workers who postpone entering the labor force have over those who get jobs at younger ages. Because many years of low or no earnings can be ignored in calculating AIME, the former group currently experiences little or no loss of benefits for its additional years spent not working and thus not paying Social Security taxes.

Opponents argue that because some beneficiaries elect early retirement for such reasons as poor health or unemployment, this proposal would adversely affect recipients who were least able to continue working. Other workers who would be disproportionately affected include those with significant periods outside the Social Security system, such as parents--usually women--who interrupted their career to rear children and workers who were unemployed for long periods of time.

ENT-33 ELIMINATE SOCIAL SECURITY BENEFITS FOR CHILDREN OF RETIREES AGES 62 TO 64

Savings from Current-Law Spending	Annual Savings (Millions of dollars)					Five-Year Cumulative Total
	1998	1999	2000	2001	2002	
Outlays	90	250	410	490	490	1,730

Unmarried children of retired workers are eligible for Social Security benefits as long as they are under age 18, attend elementary or secondary school and are under age 19, or become disabled before age 22. A child's benefit is equal to one-half of the parent's basic benefit, subject to a dollar limit on the maximum amount receivable by any one family. If such benefits were eliminated for the children of retirees ages 62 through 64, beginning with retirees reaching 62 in October 1997, the savings would total $1.7 billion over the next five years.

This option might encourage some early retirees to stay in the labor force longer. At present, although benefits for retired workers and their spouses are actuarially reduced if retirement occurs before age 65, children's benefits are not. Further, the younger the workers are, the more likely they are to have children under 18. Thus, workers under 65 now have an incentive to retire while their children are still eligible for benefits, although that incentive is quite small for families in which spouses are also entitled to dependents' benefits. For those families, the increase in total benefits attributable to all eligible children cannot exceed 38 percent of the worker's primary insurance amount.

However, for families with workers whose retirement was not voluntary--because of poor health or unemployment, for example--the loss in family income might cause some hardship. Moreover, since spouses under 62 receive benefits only if their children under age 16 also receive benefits, eliminating children's benefits for families of early retirees would also result in the entire loss of benefits for spouses in some families. In such cases, the total loss of income would generally be large.

A different approach would apply the same actuarial reduction to children's benefits that is applied to the benefits of the worker on whom those benefits depend. Thus, for example, the child of a worker retiring at age 62 would receive a maximum of 40 percent of the parent's basic benefit, instead of the 50 percent that is currently allowed. Such an approach would avoid large losses in benefits for workers with young children, but would save less.

ENT-34 CONSIDER VETERANS' COMPENSATION WHEN DETERMINING SOCIAL SECURITY DISABILITY INCOME PAYMENTS

Savings from Current-Law Spending	Annual Savings (Millions of dollars) 1998	1999	2000	2001	2002	Five-Year Cumulative Total
Coordinate Benefits for All Veterans Receiving Compensation						
Outlays	70	105	115	125	135	550
Coordinate Benefits for Veterans Newly Awarded Disability Insurance						
Outlays	5	20	35	50	65	175

People with disabilities may qualify for cash payments from more than one source, including the Social Security Disability Insurance (DI) program, veterans' compensation, workers' compensation, means-tested programs such as Supplemental Security Income, and private disability insurance. If they are younger than 65 and covered under Social Security, workers who are unable to work because they are physically or mentally impaired may qualify for DI payments.

When Social Security beneficiaries are eligible for multiple disability benefits, ceiling arrangements limit combined public disability benefits to 80 percent of the workers' average earnings before they were disabled. The combined payment after the reduction is adjusted periodically for changes in the cost of living and national average wage levels. Veterans' compensation payments for disabilities, however--as well as means-tested benefits and certain benefits based on public employment--are not included when applying the ceiling.

Approximately 2.3 million veterans--about 1.3 million of whom are under age 65--receive compensation for service-connected disabilities. The amount of compensation is based on a rating of an impairment's average effect on a person's ability to earn wages in civilian occupations. Additional allowances are paid to veterans whose disabilities are rated 30 percent or higher and who have dependent spouses, children, or parents. An estimated 100,000 veterans who receive compensation also receive DI payments from the Social Security program.

This option, which has two variations, would include veterans' compensation within the scope of the ceiling. (The combined payment, however, would never be less than either the DI benefit or the veterans' compensation payment.) Under both versions, compensation would be totaled when determining how much the DI benefit of an individual who is under 65 years old would be reduced to keep the combined benefit from exceeding the ceiling. One version of the option would apply that change to all current and future recipients of DI benefits. The other version would limit application of the option to veterans who newly qualify for Disability Insurance benefits.

Applying the change to both current and future recipients of veterans' compensation would affect an estimated 40,000 recipients in 1998 and would save an estimated $550 million over the 1998-2002 period. Applying the change only to veterans who were newly awarded compensation payments would affect an estimated 25,000 recipients by 2002 and would save an estimated $175 million over the 1998-2002 period.

Putting those options into effect would mean that an explicit policy would determine the total amount of public compensation for veterans who have service-connected disabilities. Thus, the federal government would treat in a more consistent way people who re-

ceive cash disability payments from multiple programs that are not means-tested. Both versions of the option could, however, be seen as subjecting Social Security disability benefits to a form of income testing. Moreover, under the variation of this option that would apply to current recipients of DI benefits, the incomes of some disabled veterans would drop.

ENT-35 END FUTURE VETERANS' COMPENSATION PAYMENTS FOR CERTAIN VETERANS WITH LOW-RATED DISABILITIES

Savings from Current-Law Spending	Annual Savings (Millions of dollars) 1998	1999	2000	2001	2002	Five-Year Cumulative Total
Budget Authority	34	105	179	256	337	911
Outlays	31	99	188	235	331	884

Approximately 2.3 million veterans who have service-connected disabilities receive veterans' disability compensation benefits. The amount of compensation is based on a rating of the individual's impairment that is intended to reflect an average reduction in the ability to earn wages in civilian occupations. Veterans' disability ratings range from zero to 100 percent (most severe). Veterans unable to maintain gainful employment who have ratings of at least 60 percent are eligible to be paid at the 100 percent disability rate. Additional allowances are paid to veterans who have disabilities rated 30 percent or higher and who have dependent spouses, children, or parents. Receiving veterans' disability compensation does not affect the level of Social Security disability benefits to which an individual may be entitled (see ENT-34).

About 60,000 veterans who have disability ratings below 30 percent are added to the rolls every year, receiving benefits of between $74 and $179 a month. Federal outlays could be reduced by $884 million during the 1998-2002 period by ending benefits for low-rated disabilities in future cases.

Ending compensation benefits in the future for veterans with disability allowances below 30 percent would concentrate spending on the most impaired veterans. Because performance in civilian jobs depends less now on physical labor than when the disability ratings were originally set, and because improved reconstructive and rehabilitative techniques are now available, physical impairments rated below 30 percent may not reduce veterans' earnings. Low-rated disabilities include conditions such as mild arthritis, moderately flat feet, or amputation of part of a finger--conditions that would not affect the ability of veterans to work in many occupations today.

Veterans' compensation could be viewed, however, as career or lifetime indemnity payments owed to veterans disabled to any degree while serving in the armed forces. Moreover, some disabled veterans--especially older ones who have retired--might find it difficult to increase their working hours or otherwise make up the loss in compensation payments.

ENT-36 END VETERANS' DISABILITY AND DEATH COMPENSATION AWARDS IN FUTURE CASES WHEN A DISABILITY IS UNRELATED TO MILITARY DUTIES

Savings from Current-Law Spending	Annual Savings (Millions of dollars)					Five-Year Cumulative Total
	1998	1999	2000	2001	2002	
Budget Authority	46	142	242	348	459	1,237
Outlays	41	130	259	307	446	1,183

Veterans are eligible for disability compensation if they either receive or aggravate disabilities during active military service. Service-connected disabilities are defined as those resulting from diseases, injuries, or other physical or mental impairments that occurred or were intensified during military service, excluding those resulting from willful misconduct. Disabilities need not be incurred or made worse while performing military duties to be considered service-connected; for example, disabilities incurred while on leave also qualify. The federal government gives death compensation awards to survivors when a service-connected disability is related to the cause of death.

As many as 50 percent of veterans receiving compensation payments may be receiving compensation for injuries or diseases not related to the performance of military duties. Ending disability and death compensation awards in future cases in which a disability is neither incurred nor aggravated while performing military duties would reduce outlays by $1.2 billion over five years. Approximately 2 percent of those savings would come from reduced death compensation awards.

This option would make disability compensation of military personnel comparable with disability compensation of federal civilian employees under workers' compensation arrangements. Because military personnel are assigned to places where situations may sometimes be volatile, however, they have less control than civilians over where they spend their off-duty hours. Therefore, in many cases it might be difficult to determine whether a veteran's disease, injury, or impairment was entirely unrelated to military duties. The formal appeals system of the Department of Veterans Affairs (VA) could be extended to cover rulings specifying that disabling conditions were unrelated to military duties.

Data collected by the VA indicate that about 230,000 veterans receive VA compensation payments totaling $1.1 billion a year for diseases that the General Accounting Office (GAO) reports are generally neither caused nor aggravated by military service. The diseases include arteriosclerotic heart disease, diabetes mellitus, multiple sclerosis, Hodgkin's disease, chronic obstructive pulmonary disease (including chronic bronchitis and pulmonary emphysema), hemorrhoids, schizophrenia, osteoarthritis, and benign prostatic hypertrophy. Ending new awards for veterans with those diseases would have a more limited impact than this option because it would not affect all veterans whose compensable disabilities are not connected with military service. It could, however, eliminate compensation for some veterans whose disabilities GAO finds are not generally service-connected but whose circumstances constitute an exception from this general conclusion. That approach would yield smaller savings than the previous measure--about $400 million over the 1998-2002 period.

ENT-37 ELIMINATE "SUNSET" DATES ON CERTAIN PROVISIONS FOR VETERANS IN THE OMNIBUS BUDGET RECONCILIATION ACT OF 1993

Savings from Current-Law Spending	Annual Savings (Millions of dollars)					Five-Year Cumulative Total
	1998	1999	2000	2001	2002	
Budget Authority	0	649	661	674	692	2,675
Outlays	0	642	742	672	728	2,638

Four provisions in law that affect veterans will cease to apply on September 30, 1998--their "sunset" date. As a result, starting in 1999, outlays will be higher than if the provisions remained in effect. Those provisions have:

- Protected the monthly benefit for certain pensioners who have no dependents and are eligible for Medicaid coverage for nursing home care, thus saving the Department of Veterans Affairs (VA) pension costs but increasing costs for the Medicaid program, which is paid for by the federal and state governments;
- Authorized the Internal Revenue Service to help the VA verify incomes reported by beneficiaries, for the purpose of establishing eligibility for pensions and benefits;
- Increased the fees charged for first-time and repeated use of the veterans home loan program;
- Authorized the VA to collect from any health insurer that contracts to insure a veteran with service-connected disabilities the reasonable cost of medical care provided by the VA for the treatment of non-service-connected disabilities; and
- Authorized the VA to charge copayments to certain veterans receiving inpatient and outpatient care and outpatient medication from agency facilities.

This option would make the effects of those provisions permanent by eliminating the sunset date in each case. If all four provisions were made permanent, savings from current-law spending during the 1998-2002 period would total almost $2.7 billion.

The main advantage of this option is that it would convert the temporary savings achieved by those provisions into continuing savings. The main disadvantage of the option is that certain veterans or their insurers would be worse off financially. States would also face higher Medicaid costs because of withdrawn federal funds for nursing home care.

ENT-38 REVISE THE TERMS OF THE MONTGOMERY GI BILL PROGRAM

Savings from Current-Law Spending	Annual Savings (Millions of dollars)					Five-Year Cumulative Total
	1998	1999	2000	2001	2002	
Budget Authority	110	128	144	162	180	724
Outlays	110	128	144	162	180	724

The Montgomery GI Bill (MGIB) was created as a reward for military service and an incentive for young people to enlist in the armed forces. Since its establishment in 1985, the program has helped to fund the education of nearly 560,000 participants, more than one-half of whom received benefits in 1996. A person beginning active duty can choose to participate by contributing $100 a month for the initial 12 months of service--an amount that has not increased since the program's inception. Veterans or active-duty personnel can then elect to begin receiving benefits--about $417 a month for a full-time program of study in 1996--when they enroll in an authorized program of study. In addition, about 94,000 veterans and members of the selected reserves are eligible for about $198 a month in MGIB benefits. Members of the reserves make no contribution. The size of the benefit, for veterans of both active duty and selected reserve service, is indexed to the consumer price index (CPI), and those who began a full-time program of study in 1996 can expect to receive benefits totaling as much as $15,000 (in 1996 dollars) under current law.

This option would limit the cost of the MGIB in three ways. First, it would lower the cost-of-living adjustment (COLA) in benefits to one-half the change in the CPI. Second, it would raise the initial contribution of active-duty personnel from $1,200 to about $1,600 in 1998 and increase it in subsequent years by the same percentage that benefits are increased. Third, the option would require a contribution from reserve personnel proportional to the contributions from the active force; it would also subject their benefits to the lower COLA. Those three changes would save $110 million in 1998 and a total of $724 million through 2002.

Opponents of the option would argue that the MGIB is an effective tool for recruiting the kinds of people that the nation needs to operate high-technology weapons and other equipment. They would contend that the MGIB is more cost-effective than enlistment bonuses in expanding the pool of prospective recruits. It encourages recruits to complete their initial term of enlistment and increases the probability that they will join a reserve component. Opponents would also argue that current and prospective members of the military would view this option as an erosion of benefits and a sign that the military places a lower value on recruiting well-motivated and highly skilled individuals. Moreover, if reducing benefits would affect recruiting and force the military services to expand other recruiting programs, savings from curtailing MGIB benefits would overstate net savings to the Department of Defense (DoD). Opponents would also observe that college costs have continued to rise about twice as fast as the CPI. Therefore, continuing the current growth rate of benefits is necessary for MGIB to be an effective enlistment incentive.

Conversely, proponents of this option would say that current law has allowed benefits to increase with inflation but keeps contributions fixed, thus providing a richer net benefit each year. At the program's inception, benefits were nine times greater than contributions. They are now more than 12 times greater than the contributions--and the multiple will continue to grow every year unless the Congress acts to change the program. Proponents would argue that this increasing generosity cannot be justified by the need to recruit a high-quality force; DoD has exceeded its quality goals every year since at least 1992. The Department of Defense wants 90 percent of its recruits to have a high school diploma and 60 percent to score above average on the Armed Forces Qualifying Test (AFQT). In just the last two years, new recruits have exceeded these standards--each year, 96 percent had high school diplo-

mas and about 70 percent scored above average on the AFQT. Moreover, the armed forces need a smaller percentage of the targeted population than they did in the 1980s when the program was created and the force was larger by half. Proponents of the option would argue that fine-tuning this educational benefit to the post-Cold War environment would still allow DoD to maintain a highly skilled force. Finally, MGIB did not provide for any cost-of-living adjustment in benefits for its first seven years and only provided for a half COLA when such adjustments were initially made. In keeping with this history, the Senate Veterans Affairs Committee unanimously passed a provision containing a half COLA in its Reconciliation Recommendation of 1995.

ENT-39 EXTEND AND INCREASE COPAYMENTS ON DRUGS AND MEDICAL SUPPLIES PROVIDED TO VETERANS

Savings from Current-Law Spending	Annual Savings (Millions of dollars) 1998	1999	2000	2001	2002	Five-Year Cumulative Total
Extend Copayment Requirement Beyond 1998						
Budget Authority	0	36	38	39	41	153
Outlays	0	36	38	39	41	153
Increase Copayment Amount						
Budget Authority	0	176	236	298	301	1,012
Outlays	0	176	236	298	301	1,012
Add Over-the-Counter Copayment						
Budget Authority	0	182	250	319	322	1,074
Outlays	0	182	250	319	322	1,074

After 1998, unless the Congress acts, the Department of Veterans Affairs (VA) will deliver a comprehensive range of medical benefits to many veterans at no charge. For example, a provision setting a $2 copayment for prescription drugs will expire in September 1998. When it does, VA pharmacies will return to a practice of filling, at no cost to the veteran, prescriptions for drugs as well as pharmacy products that are generally available over the counter (OTC) at retail pharmacies. To illustrate alternatives to that practice, CBO developed three options: the first would merely extend the prescription drug and OTC copayments required under current law; the second would gradually increase the amount of that copayment; and the third would increase currently required copayments and add a new copayment for OTC products that are currently provided free of charge.

Extension of Copayments Under Current Law. Current law provides that the VA will charge veterans a $2 copayment for a 30-day supply of a prescription drug, OTC medication, or dietary supplement. According to the General Accounting Office (GAO), the most frequently prescribed OTC medications are aspirin and insulin, and the most frequent dietary supplements are Sustacal and Ensure. Not all veterans are required to pay. Those who are admitted to hospitals, have a service-connected disability rated 50 percent or more, or lack the resources to pay are exempt from the requirement.

This option would eliminate the sunset provision in current law and extend the $2 copayment indefinitely. (That is one of several sunset provisions analyzed in ENT-37.) The action would save $153 million from 1999 through 2002.

Increase the Copayment for Prescription Drugs and OTC Medications. Another option would extend the copayment requirement and gradually increase the copayment amount. The copayment would increase by $1 a year, until it reaches $5 for a 30-day supply. This option would go a step further and require that the VA collect the copayment in all applicable cases by removing discretion in collecting the copayment. (Currently, VA facilities collect only a portion of the applicable copayments.) Increasing the copayment amount and removing VA discretion would save $176 million in 1999 and about $1 billion through 2002.

Proponents might argue that eventually requiring a $5 copayment would make the VA benefit for prescription drugs more consistent with other health delivery systems, including Medicare and managed care pro-

grams in the private sector. Even in Medicaid programs, nominal copayments help offset benefit costs and provide economic incentives for more prudent consumption of prescriptions.

Opponents might charge that some veterans who have multiple chronic illnesses may be overburdened by the increased cost sharing. They might claim that this requirement would place an undue financial burden on chronically ill veterans and their families. To avoid this, the Congress could limit the total number of prescriptions subject to a copayment in any given month.

Over-the-Counter Medical Supplies. For even greater savings, the VA could gradually institute a $6 copayment for a 30-day supply of OTC medical supplies, in addition to the copayment for OTC medications and dietary supplements. (According to the GAO, the most frequent OTC medical supplies are alcohol prep pads and glucose test strips.) That option would make the copayment $2 in 1998, $4 in 2000, and $6 in 2001 and thereafter. This option also assumes that the VA would collect a copayment in all of the applicable cases. A copayment for OTC medical supplies, coupled with the increase in existing copayments described above, would save a total of $182 million in 1999 and nearly $1.1 billion over the 1999-2002 period.

Proponents could argue that there is no clinical reason that OTC medical supplies should be exempt from beneficiary cost sharing. Most public and private health programs, even the most generous, do not cover OTC products, except for insulin and related supplies. The VA's pharmacy benefit is generous, even with the current $2 copayment on OTC medications and dietary supplements. The option would make the copayments more consistent with those for OTC pharmacy items. Also, cost sharing would enhance the economic incentives for more prudent consumption of medical supplies.

Opponents of the option may be concerned that veterans would be worse off financially under it. Veterans who have multiple chronic conditions that are not related to service and are treated mainly with OTC medical supplies from the VA could see substantial increases in their out-of-pocket costs. Although low-income veterans would be exempt from the copayment, others might be discouraged from using certain OTC medical supplies from the VA, which could affect the quality of their care.

ENT-40 INCREASE BENEFICIARY COST SHARING FOR VA NURSING FACILITY CARE

Savings from Current-Law Spending	Annual Savings (Millions of dollars) 1998	1999	2000	2001	2002	Five-Year Cumulative Total
Budget Authority	279	289	299	309	320	1,496
Outlays	279	289	299	309	320	1,496

Veterans may receive long-term care in a nursing home run by the Department of Veterans Affairs (VA), depending on the availability of resources. Such care is rationed primarily on the basis of service-connected disabilities and income. Under certain conditions, a veteran may also receive care at VA expense in state-operated or privately run nursing homes.

The Department of Veterans Affairs (VA) does not collect a copayment unless the veteran has no service connected disabilities and has an income above a certain level. By contrast, state-operated homes for veterans and community long-term care facilities that treat veterans apply their own copayment policies. In 1995, veterans who were required to contribute toward the cost of Vaoperated nursing home care paid a rate equivalent to about $13 a day. A study by the General Accounting Office found that the VA recovers less than one-tenth of 1 percent of the costs of operating its own nursing facilities, but state-operated veterans' nursing facilities are known to recover as much as 43 percent of their operating expenses through copayments. Estate recovery programs are another way to offset costs.

This option would require the VA to recover 10 percent of the operating costs for its own nursing facilities. The savings could come from applying the current copayment requirement to a broader category of veterans or from raising the copayments required of veterans who are currently required to contribute. Recovering 10 percent of VA operating costs would save $279 million in 1998 and $1.5 billion over five years. (Achieving those savings would require that the VA not be allowed to retain and spend the receipts; instead, they would be deposited in the Treasury.)

Proponents of this option would argue that veterans in VA-run nursing homes are getting a far more generous benefit than similar veterans in other facilities or those who receive the same kind of care at their home. Because VA-run nursing homes are relatively scarce, veterans lucky enough to be admitted to one have an unfair advantage over those who are equally deserving. Recovering more of the expenses of VA nursing homes would make the benefit more equitable among veterans and sites of care.

Opponents of this option would argue that beneficiaries in VA nursing facilities may have less ability to make copayments than beneficiaries in state-operated homes. For example, VA disability compensation payments cease when veterans get long-term care directly from the VA, unlike payments to veterans in state-run homes. Thus, they would claim that to recover 10 percent of its operating expenses, the VA would have to place an unfair burden on veterans who are now required to make copayments.

ENT-41 ELIMINATE THE PRESIDENTIAL ELECTION CAMPAIGN FUND AND RAISE THE LIMIT ON PRESIDENTIAL CAMPAIGN CONTRIBUTIONS BY INDIVIDUALS

Savings from Current-Law Spending	Annual Savings (Millions of dollars)					Five-Year Cumulative Total
	1998	1999	2000	2001	2002	
Outlays	0	26	230	44	1	301

Presidential campaigns are unique among contests for federal office because, by and large, they are financed by public money. Under current law, the public finances a large share of the costs of Presidential campaigns through the federal income tax "check-off" program. By voluntarily designating a portion of their annual federal income tax liability--$3 for individual filers and $6 for joint returns--taxpayers earmark funds for the Presidential Election Campaign Fund (PECF). Subsequently, during each Presidential election cycle, those public funds are made available by the Treasury to Presidential candidates and political parties that are certified by the Federal Election Commission as meeting federal eligibility requirements. During the 1996 Presidential campaign, for example, about $235 million was disbursed from the PECF. By contrast, candidates for office in the Senate or House of Representatives rely solely on private funds to cover the costs of their campaigns.

In return for public funding, Presidential candidates and political parties agree to comply with federally imposed limits on campaign expenditures. Candidates who do not accept public funding, the Supreme Court has ruled, may not be restricted in their spending. However, all candidates must adhere to federal limits on campaign contributions that restrict donations by individuals to $1,000. That is the same limit that was imposed in 1974 when contribution limits first became effective.

The Congress could eliminate the Presidential Election Campaign Fund after the 1996 election cycle and raise the threshold on contributions by individuals to account for price changes since 1974. A similar proposal was included in the original version of the Senate budget resolution for fiscal year 1996. By terminating the check-off program and raising the contribution limit, the government could save about $300 million over the next five years, and Presidential candidates and political parties would be given sufficient notice to adjust their fundraising activities.

Public funds are provided through the PECF in three main ways. First, dollar-for-dollar matching funds for contributions by individuals of up to $250 are made available to Presidential primary candidates who meet federal eligibility requirements. To become eligible, candidates must raise $5,000 or more in each of 20 states in matchable individual contributions of $250 (that is, $100,000 in all).

Second, the PECF provides entitlements to major political parties to cover the costs of nominating conventions. Existing minor political parties may also become eligible to receive grants, but in amounts that are a fraction of those for major parties. New political parties, however, are not eligible to receive grants for nominating conventions.

Third, the PECF provides entitlements to the general election candidates of major parties and to the candidates of minor and new parties, but in lesser amounts. The candidates of minor political parties may receive funding on the basis of political performance in the previous Presidential election, and postelection subsidies are made available to candidates of new parties on the basis of electoral performance. For example, because Ross Perot obtained nearly 50 percent of the average popular vote received by the two major party candidates during the 1992 Presidential election, he was entitled to about $29 million in federal funding for his 1996 campaign effort. By contrast, the major candidates each received $61.8 million after their party's nominating convention--the amount of the general election spending limit before the November 1996 election.

Critics of public financing for Presidential campaigns assert that the current system has not achieved its primary objectives of limiting the influence of special interests and eliminating the potential for financial misdeeds in Presidential elections. They also maintain that the limits on contributions by individuals and on campaign spending by candidates who accept public money are excessively low: the individual limit has never been adjusted to reflect growth in prices since 1974, and the spending limits do not reflect general trends in election spending. As a result, candidates are forced to devote a disproportionate share of their time to fundraising activities, and political parties and candidates are encouraged to exploit loopholes in the law and search for ways to circumvent spending and contribution caps.

In addition, many critics find little justification in providing such a large targeted benefit; millions of dollars in taxpayer funds are given to a handful of major party Presidential candidates, to well-financed political parties for nominating conventions, and to fringe candidates with no real chance of electoral success. Other critics argue that the eligibility requirements strongly favor the major parties at the expense of minor and new parties. They contend that a system of reasonable and strictly enforced contribution limits in conjunction with full public disclosure could better serve the public interest and reduce the costs of government.

Some critics also argue that the public funding system has had a negative impact on the electoral process. Because of the rigid limits imposed by the Federal Election Campaign Act of 1971 on candidates who accept public funds and on the activities of volunteers, they contend that the system has encroached on direct participation by voters and dampened civic enthusiasm. In the six Presidential elections that have taken place since public funding was introduced, average voter turnout was 12.7 percent lower than in the six previous elections. Finally, critics point to the income tax check-off program as evidence that a majority of citizens are opposed to public funding; less than 15 percent of taxpayers checked the box on their income tax returns.

Proponents of public funding point to the system's quiet successes. They contend that Presidential elections have been generally free from financial scandal and corruption since the system's inception, and the outcomes of elections have been determined largely on the merits of issues and individual candidates rather than on the ability to solicit large donations. Moreover, it is argued that through the PECF, the government is simply protecting the integrity of the electoral process and that the funding provided is not a high price for the nation to pay. Similarly, public funding has permitted several candidates who might otherwise have been shut out for lack of resources to make meaningful contributions to the national debate. In addition, those in favor of public funding assert that the money that minor party candidates qualify for constitutes a very small portion of total public spending on presidential elections (for the five elections between 1976 and 1992, the amount was less than 2 percent) and increases the chance that new voices will be heard in the campaign.

Proponents also claim that without public financing, the influence of special-interest money would become even more pervasive. Substituting higher limits on individuals' contributions for public funding, it is argued, would increase the political influence of wealthy contributors. Last, supporters of the current system argue that people who participate through the check-off program compose the single largest group of contributors to political campaigns--larger than direct contributors, campaign and party volunteers, or voters in Congressional elections. Thus, terminating the check-off program would significantly narrow the base of political contributors.

ENT-42 IMPOSE A COST-OF-CAPITAL OFFSET FEE ON FANNIE MAE AND FREDDIE MAC

Savings from Current-Law Spending	Annual Savings (Millions of dollars) 1998	1999	2000	2001	2002	Five-Year Cumulative Total
Budget Authority	900	900	900	900	900	4,500
Outlays	900	900	900	900	900	4,500

The interest rate that a firm must pay to borrow money depends on its credit rating. Greater financial strength in a borrower implies a higher level of credit quality (that is, less risk to the lender) and generally lowers the interest and other costs that borrowers must pay to obtain funds. But financial strength--especially when it is based on large amounts of shareholder-provided equity --comes at a price: shareholders must be compensated for the use of their money, which is at risk while it is raising the credit rating of the company.

The federal government helps government-sponsored enterprises (GSEs) reduce the cost of money from all sources by putting taxpayers' equity behind the GSEs' financial obligations. (A GSE is an enterprise that is established and chartered by the government for a specific financial purpose but is wholly owned by private stockholders.) The government's equity infusion is based on several provisions of law, including one that exempts the GSEs from many federal and state regulations designed to protect investors, and another that gives the GSEs a line of credit at the U.S. Treasury. Through such laws, the federal government sends a signal to investors that promises issued by a GSE are less risky than the GSE's financial condition would suggest. In other words, the federal government is a "shadow" provider of equity capital to the GSE; it stands in for other investors whose capital would be required in the government's absence to bolster the GSE's credit rating, and who would demand compensation for the use of their money.

As a consequence of the federal presence, GSEs are able to obtain funds in the capital markets at lower interest rates than those paid by private borrowers of comparable financial condition. Although estimates are uncertain, two of the GSEs--the Federal National Mortgage Association (FNMA, or Fannie Mae) and the Federal Home Loan Mortgage Corporation (FHLMC, or Freddie Mac)--probably save 70 cents (70 basis points) every year on every $100 of long-term debt that they owe because of their affiliation with the federal government. On mortgage-backed securities (MBSs) issued and guaranteed by the two GSEs, the cost advantage is smaller; nevertheless, it is probably about 35 cents (35 basis points) for every $100 of securities outstanding each year. Although those amounts might seem to be of small benefit, they add up to more than $6 billion a year because Freddie Mac and Fannie Mae have well over $1 trillion in outstanding securities. GSEs do not pay the government a fee or any other monetary compensation for the reduced cost of capital that they enjoy as a result of their status as sponsored enterprises. Instead, the GSEs pass through some of the savings in lower mortgage interest rates and provide mortgage market stabilization and leadership functions for the government.

More than 20 years ago, the federal government chartered Freddie Mac and Fannie Mae to give local retail mortgage lenders a conduit to the vast sums of money available in the bond markets. In doing so, the government hoped to avoid periodic credit shortages for home buyers. Federal policy giving mortgage lenders access to Wall Street through Fannie Mae and Freddie Mac has clearly succeeded. In successfully channeling money from investors to home buyers and back to investors, the housing GSEs have demonstrated the profitability of such activity. Consequently, credit is now reliably available to home buyers at all times. But an unfortunate side effect has been that the two GSEs now virtually monopolize the resale, or "secondary," market for the home mortgages they are permitted to buy. The GSEs dominate the market because the federal government's dividend-free equity reduces the cost of funds below that available to private competitors.

An offset fee based on the savings in capital costs that Freddie Mac and Fannie Mae derive from federal affiliation would be a step toward more equitable competition in the secondary market. In addition, it would partially compensate taxpayers for the value of the capital services that the government provides. Because of the differential effect of federal affiliation, fees need not be applied to both debt and mortgage-backed securities. (Such securities essentially give their buyers rights to share in the future stream of income generated by a large pool of mortgages put together by the GSE.) In fact, a fee of 20 basis points on average debt outstanding and no fee at all on MBSs would produce annual federal collections of $900 million based on the outstanding debt of the GSEs.

Initially, the fee would reduce the two GSEs' net income, which was $4 billion (after taxes) in 1996. Fannie Mae and Freddie Mac, however, could choose to avoid the fee by switching their financing sources from debt securities to MBSs. The housing GSEs may be reluctant to switch their funding to MBSs because the federal subsidy on debt would remain higher than on MBSs after the fee. Since no fee would be applied to MBSs, there would be no need for mortgage interest rates to rise.

From the taxpayers' perspective, a disadvantage of the fee is that it would reduce the market value of the enterprises and thereby reduce the cost to investors of "abandoning" the GSE to the government and sticking taxpayers with any accumulated losses. Of course, that is a disadvantage of any proposal that would reduce GSE subsidies, which are supporting the market value of the enterprises. As a reduction in the subsidy given to Fannie Mae and Freddie Mac, collections from the fee would be credited to a Treasury account as offsetting receipts, which are paid into the general fund. That same treatment has been applied to such fees proposed in the budget requests of previous Presidents.

Several federal agencies, including the Congressional Budget Office, have studied the feasibility and desirability of privatizing Freddie Mac and Fannie Mae. If the Congress decided to sever the federal government's links to those GSEs and thereby terminate the subsidy, the cost-of-capital offset fee would need to be repealed.

ENT-43 ELIMINATE THE ONE-DOLLAR BILL AND REPLACE IT WITH A NEW DOLLAR COIN

	Annual Budgetary Effects (Millions of dollars)					Five-Year Cumulative Total
	1998	1999	2000	2001	2002	
Revenues						
Addition to Current-Law Revenues	0	0	0	80	110	190
Direct Spending						
Increase (+) or Decrease (-) in Costs to the U.S. Mint						
Budget authority	89	282	-217	-142	-2	10
Outlays	89	282	-217	-142	-2	10

The United States is one of the few industrialized countries that continues to use paper bills for sums as small as a dollar. By contrast, the smallest paper note denominations in Spain (500 peseta/$3.50), France (20 franc/$3.50), Germany (10 mark/$5.90), Switzerland (10 franc/$6.85), and Great Britain (5 pound/$8.10) are significantly more valuable than the one-dollar bill.

Each year, the Bureau of Engraving and Printing (BEP) within the Department of the Treasury manufactures billions of currency notes, and one-dollar notes account for approximately 40 to 50 percent of the total produced. Vast quantities of one-dollar notes must be printed each year because they lack durability: they circulate, on average, only 18 months before they must be retired. By contrast, coins may remain in circulation for up to 30 years. Because of that longevity, the long-run annual cost of keeping a dollar coin in circulation would be about 2 cents to 3 cents lower than the corresponding cost of a note.

Because the federal budgetary accounting of coin and currency operations is extraordinarily complex, enacting this proposal would affect three areas of the budget: revenues, direct spending, and the cost of financing the federal deficit. The net budgetary effect of eliminating the one-dollar bill and replacing it with a coin would be to reduce the deficit by $180 million over the next five years. This estimate assumes 30 months of lead time for the U.S. Mint to produce and stockpile new dollar coins before their introduction into circulation.

First, revenues would increase by $190 million over the next five years. Revenues would rise because the costs to the government (that is, the Federal Reserve System) of producing and maintaining the nation's supply of currency would fall. Costs would decline because the Federal Reserve could forgo annual purchases of billions of one-dollar notes (although the decline would be offset in part by the cost of increased purchases of two-dollar notes) and because coins would not require the more costly inspection that notes currently receive. As a result, Federal Reserve System earnings, which are remitted to the Treasury and counted in the federal budget as miscellaneous receipts (revenues), would rise. Moreover, significant increases in revenues would accrue in the long run--on the order of $150 million per year--once the changeover from notes to coins was complete.

Second, net direct spending by the government would increase by $10 million over the next five years. Direct spending would increase in the short run because of a lag between the time the Mint would incur the costs of producing a new dollar coin and the date on which the government would circulate and realize a profit on it. Costs include research and development, metals acquisition, new capital equipment, storage for coins stockpiled before their circulation, and a public aware-

ness campaign. In the first two years, those costs would increase direct spending by an estimated $371 million. The resources to pay for increased direct spending would come from the profit (or seigniorage, the difference between the face value of coins and their cost of production) that the government earns on the manufacture of existing coins and their subsequent deposit at the Federal Reserve. Beginning in fiscal year 2000, the Mint would recoup those costs. Previous increases in direct spending would be fully offset in the budget by 2002, except for that portion of Mint costs attributable to depreciation of new capital equipment. Over time, however, the net effect on direct spending would be zero.

Third, replacing one-dollar notes with coins would reduce the cost of financing the federal deficit, which would lead to long-run savings far greater than the direct savings to the government through 2002. Such long-run savings would be generated only if the public was willing to hold more than a single dollar coin for each one-dollar note. In fact, the experience of other countries strongly suggests that the public would hold a larger amount of non-interest-bearing coin and currency after the conversion is complete. For example, the Federal Reserve and the General Accounting Office estimate that the public would hold $9 billion in one-dollar coins and $1.5 billion in additional notes for the $6 billion in one-dollar bills that is currently held. That would permit the government to finance $4.5 billion of federal debt by issuing non-interest-bearing coins and currency instead of interest-bearing Treasury securities. With interest rates at 6 percent, the government would save $270 million in interest per year. Because interest costs would be reduced in the first year, borrowing from the public would be lower in all subsequent years, resulting in additional savings. However, the effects on federal borrowing are not included in the estimate for any option because they constitute an indirect or second-order budgetary impact.

Proponents of replacing one-dollar notes with a dollar coin also argue that a coin would be easier for the visually impaired to distinguish and easier to use in most vending machines. They say that the dollar coin would also increase the speed of many low-level business transactions. Conversely, critics argue that the government would need to take strong measures to ensure the coin's acceptance and avoid the failures associated with the Susan B. Anthony dollar. According to that view, the government would have to be prepared to eliminate the dollar note completely, ensure that the new coin's form was distinct from those of other coins, and promote it vigorously. Even so, critics contend there is no guarantee that a new dollar coin would gain public acceptance. Coins are bulky, and commercial banks, which shoulder the majority of coin processing costs, would see their expenses rise. Finally, critics assert that the focus on budgetary savings should not come at the expense of other significant factors, such as the importance of a convenient currency, an efficient payments system, and a coin that meets the needs of citizens.

ENT-44 RESTRICT COST-OF-LIVING ADJUSTMENTS IN NON-MEANS-TESTED BENEFIT PROGRAMS

Savings from Current-Law Spending	Annual Savings (Millions of dollars) 1998	1999	2000	2001	2002	Five-Year Cumulative Total
Eliminate COLAs for One Year						
Social Security and Railroad Retirement	7,850	10,630	10,830	10,880	10,890	51,080
Other Non-Means-Tested Programs	1,950	2,530	2,710	2,670	2,770	12,640
Offsets in Means-Tested Programs and Medicare Premiums	-660	-490	-370	-380	-380	-2,270
Total	9,140	12,670	13,170	13,170	13,280	61,450
Limit COLAs to Two-Thirds of the CPI Increase for Five Years						
Social Security and Railroad Retirement	2,610	6,450	10,560	14,860	19,340	53,830
Other Non-Means-Tested Programs	650	1,550	2,630	3,580	4,710	13,120
Offsets in Means-Tested Programs and Medicare Premiums	-90	-340	-680	-1,040	-1,420	-3,570
Total	3,170	7,660	12,510	17,400	22,630	63,380
Limit COLAs to the CPI Increase Minus 0.5 Percentage Points for Five Years						
Social Security and Railroad Retirement	1,400	3,360	5,440	7,620	9,890	27,710
Other Non-Means-Tested Programs	350	810	1,360	1,840	2,420	6,770
Offsets in Means-Tested Programs and Medicare Premiums	-50	-170	-330	-520	-730	-1,810
Total	1,700	4,000	6,470	8,940	11,580	32,670
Pay the Full COLA on Benefits Below a Certain Level and 50 Percent of the COLA on Benefits Exceeding That Level for Five Years						
Social Security and Railroad Retirement	0	-820	-1,950	-3,130	-4,350	-10,250

Under current policies, outlays for Social Security and other non-means-tested cash transfer programs with benefits indexed to the consumer price index (CPI) are expected to total about $460 billion in 1998 and to rise to $580 billion by 2002. Reducing the automatic cost-of-living adjustment (COLA) for those programs is commonly proposed as one way to slow the growth in entitlement spending. Four strategies for reducing COLAs and the savings in outlays resulting from each are shown in the preceding table. The programs in which COLAs would be reduced under the first three options are Social Security Old-Age, Survivors, and Disability Insurance; Railroad Retirement; Civil Service Retirement; Military Retirement; workers' compensation for federal employees; veterans' compensation; and retirement benefits for the Foreign Service, the Public Health Service, and the Coast Guard. The fourth option would affect only Social Security and Railroad Retirement Tier I COLAs. (Other options for achieving savings in Social Security are given in ENT-32 through ENT-35 and REV-15.)

COLA restrictions would achieve considerable savings by exacting small reductions in benefits from a large number of people, in contrast to other budget options that would impose large reductions in benefits on smaller groups of recipients. Moreover, limiting these options to the non-means-tested cash benefit programs would protect many of the poorest beneficiaries of entitlements--for example, recipients of Supplemental Security Income--from losses of income. Finally, because the benefit levels would be permanently lowered for eligible people when the COLA limitation was established, significant reductions in outlays would persist beyond the six-year projection period. The savings would eventually disappear, however, as beneficiaries died or stopped receiving payments for other reasons, unless the COLA limitation was accompanied by a permanent reduction in the initial benefits of newly eligible workers (see ENT-32).

Another argument in favor of less-than-complete price indexing is that the consumer price index (CPI) probably overstates increases in the cost of living for the population as a whole. Many analysts feel that the CPI overstates increases in the cost of living, although the magnitude of the overstatement and what should be done about it are subject to much debate. For example, the Advisory Commission to Study the Consumer Price Index (also known as the Boskin Commission) recently estimated the size of the upward bias to be about 1 percentage point per year. To the degree that the CPI overstates increases in beneficiaries' cost of living, the COLA could be reduced without lowering beneficiaries' real benefits below what they received when they became eligible for the program.

Budget reduction strategies that institute less-than-complete price indexing would result in financial difficulties for some recipients--particularly if COLAs were restricted for an extended period. Restrictions on COLAs also encounter opposition from people who fear that changes made to reduce budget deficits would undermine the entire structure of retirement income policy. For example, because private pension plans generally do not offer complete indexing, restricting Social Security COLAs would further reduce protection for beneficiaries against inflation. Some people also think that, because Social Security and other retirement programs represent long-term commitments to both current retirees and today's workers, the programs should be altered only gradually and then only for programmatic reasons. According to that view, any changes in benefits should be announced well in advance to allow people to adjust their long-range plans.

Unless restrictions on COLAs were accompanied by commensurate changes in determining initial benefits for new recipients, disparities in benefit levels would develop among different cohorts of retirees. That situation is particularly relevant for Social Security, in which benefits for newly eligible individuals are based on an indexed benefit formula and on indexed earnings histories. For example, if prices rose by 4 percent in a year and the wage index used to compute benefits for newly eligible recipients increased by 5 percent, the act of eliminating that year's COLA without changing the calculation of initial benefits would produce benefits for new beneficiaries that were about 5 percent higher than for recent retirees; under current law, benefits would be only about 1 percent higher for the new retirees. To alleviate that problem and to achieve additional savings, efforts to slow the growth in benefits through COLA limitations might be extended to the formulas for determining initial benefits (see ENT-32).

There are several options designed to restrict COLAs for current beneficiaries. Except for the option to limit COLAs to 0.5 percentage points less than the

increase in the CPI, the magnitude of the savings in each case--as well as the impact on beneficiaries--would be very sensitive to the level of inflation in the years in which the COLAs would be reduced. If prices were to rise faster than currently assumed, savings would be greater than shown, and recipients would bear larger costs. If prices were to rise less quickly, both budgetary savings and the effect on recipients would be smaller.

The following are specific versions of COLA restrictions:

Eliminate COLAs for One Year. One option would be to eliminate COLAs in 1998 for non-means-tested benefit programs and allow them to be paid in subsequent years, but with no provision for making up the lost adjustment. If that approach was taken, federal outlays would be reduced by about $9.1 billion in 1998 and $61.5 billion over five years, with Social Security and Railroad Retirement accounting for most of the total.

Limit COLAs to Two-Thirds of the CPI Increase for Five Years. Under this approach, recipients would be compensated for only a certain proportion of inflation, such as two-thirds of the annual CPI increase. Based on the current economic assumptions of the Congressional Budget Office, applying this restriction for five years would save about $3.2 billion next year and $63.4 billion over the 1998-2002 period. As a result, benefits for people who received payments throughout the five-year period would be about 5 percent less in 2002 than they would have been under full price indexing. Furthermore, this option would reduce the real income of beneficiaries at the same time that they were becoming less able to supplement their income by working.

Limit COLAs to the CPI Increase Minus 0.5 Percentage Points for Five Years. An approach similar to the proportionate COLA reduction would reduce the adjustment by a fixed number of percentage points; for example, set the adjustment at the CPI increase minus 0.5 percentage points. Unlike other options to restrict COLAs, however, both savings and effects on beneficiaries would be roughly the same regardless of the level of inflation--about $32.7 billion over the next five years, if extended for the full period.

Pay the Full COLA on Benefits Below a Certain Level and 50 Percent of the COLA on Benefits Exceeding That Level for Five Years. Another alternative would tie the COLA reductions to beneficiaries' payment levels, starting in 1999. The example discussed here--based only on Social Security and Railroad Retirement Tier I benefits--would award the full COLA for benefits based on the first $685 of a retiree's monthly primary insurance amount (PIA) and 50 percent of the COLA on benefits above that level. The $685 per month threshold is about equal to the projected 1999 poverty level for an elderly person and would be indexed to maintain its value over time.

This approach would save about $800 million in 1999 and $10.3 billion over the 1999-2002 period. Because of the time needed to carry out the proposal, those estimates assume that it would be in place by January 1999.

Because the full COLA would be paid to beneficiaries with low PIAs, this option would ensure that low-income recipients were not adversely affected. Moreover, its percentage impact would be greater for recipients with higher benefits. Nonetheless, benefit levels are not always good indicators of total income. Some families with high benefits have little other income, whereas some with low benefits have substantial income from other sources. Furthermore, many people object to any changes in retirement programs that might be construed as introducing a means test for benefits, even if the test is limited only to the COLA.

A variation would extend this approach to the other non-means-tested benefit programs besides Social Security; that variation is not shown in the table. Such an option would spread the effects among a wider group of recipients, although it might be somewhat more complicated to design because the different benefit structure in each program could require a separate determination of the appropriate benefit levels on which to pay reduced COLAs.

Eliminating COLAs for recipients whose benefits are based on PIAs above a certain level is another option. Because such a reduction would affect the entire benefit of each recipient above the threshold, not just the portion of the benefit above that level, both the savings and the impacts on beneficiaries would be consid-

erably greater. Unless adjustments were made at the threshold, however, recipients with benefits just below it could be made better off than those with benefits just above it. Still another approach that would address some of the administrative problems of those two options would involve increased taxation of Social Security benefits (see REV-15).

ENT-45 APPLY MEANS TESTS TO FEDERAL ENTITLEMENTS

Savings from Current-Law Spending	Annual Savings (Millions of dollars) 1998	1999	2000	2001	2002	Five-Year Cumulative Total
Make Entitlements Subject to Individual Income Tax						
Non-Means-Tested Entitlements	19,900	58,100	62,700	67,000	71,400	279,100
All Entitlements	22,700	67,700	73,100	78,400	83,800	325,700
Reduce Entitlements Provided to Middle- and High-Income Families						
Non-Means-Tested Entitlements	11,800	55,700	52,300	55,900	59,600	235,300
All Entitlements	11,800	58,500	55,300	59,100	63,100	247,800
Deny Entitlements to High-Income Recipients						
Non-Means-Tested Entitlements	4,900	12,000	11,100	11,700	12,500	52,200
All Entitlements	4,900	12,200	11,300	12,000	12,800	53,200

NOTE: Estimates do not include administrative costs or revenue losses from reductions in taxable benefits.

There are two basic approaches to constraining entitlement spending. One broad strategy would reduce the growth of spending (or tax the benefits at higher rates) on a program-by-program basis. New program rules or tax laws could limit who qualifies for benefits, reduce the amount of benefits provided, or change the taxation of benefits. (Examples of that kind of approach include ENT-33, ENT-36, ENT-45, REV-15, and REV-17.)

An alternative to the program-by-program approach would constrain entitlements as a group through some form of means-testing under which benefits were cut most for beneficiaries with the highest income. Three illustrations of that method are discussed here. The first approach would subject most entitlement benefits to federal individual income taxes, the second would reduce benefits as beneficiaries' income rose, and the third would deny benefits to individuals with income above specified thresholds. The savings attributed to those three approaches would be smaller than those shown here if the Congress enacted one or more of the program-by-program approaches described in other options.

Some federal entitlements are already subject to limits on income or wealth under program regulations. The federal part of Supplemental Security Income (SSI) is available only to elderly and disabled people with monthly income below federally specified national limits. Aid to Families with Dependent Children (AFDC) goes only to families with children who have a monthly income below limits set by individual states. Recipients of SSI and AFDC are automatically eligible for Medicaid, as are certain people with low family income. Only households with a monthly income below the federal poverty guidelines qualify for food stamps. Because those and other means-tested programs currently provide benefits only to people with low monthly income, subjecting them to any of the three methods of means-testing discussed here would duplicate the cur-

rent means-testing at significantly higher income levels, imposing administrative and compliance costs but having little effect on net saving. At the same time, because each of the alternative approaches would impose an annual means test--as opposed to the monthly tests now used in each program--beneficiaries who qualified for assistance for only part of a year could lose some or all of their benefits. Budgetary savings for each approach are shown both including and excluding those transfers that are already means-tested.

Non-means-tested entitlement programs included here are Social Security and Railroad Retirement, Medicare, unemployment compensation, and veterans' benefits. Since Social Security and Medicare account for the bulk of entitlements, the options discussed here largely affect the elderly. The analysis excludes two other major entitlement programs--federal civilian and military pensions--because they are part of the labor contract between the government and its employees and not transfers in the same sense that the included programs are. Several options to constrain spending on those two excluded programs are discussed in ENT-26.

Means-testing could be based on individual income, income of couples, or the income of a more broadly defined family. The unit used determines which recipients would be affected by the alternative approaches, as well as how recipients might respond to means-testing. Because families generally consume as a unit, family income and wealth are probably better measures of need than individual income and wealth. At the same time, depending on how the means tests are structured, basing the tests on families could induce families to split up into smaller units to minimize benefit reductions. For example, in the approach to benefit reduction discussed below, a retired couple in which each spouse had $20,000 of pension and investment income and $10,000 of Social Security would lose $3,000 of their Social Security benefits; if they divorced, they would keep all of their benefits. Appropriate differentiation of benefit reductions for individuals and families of different sizes could reduce or remove such incentives for family breakup.

A significant objection to global means-testing of entitlements is that different programs serve different purposes. Individual programs provide people with separate types of in-kind consumption, such as food, housing, and medical care. Society may wish to ensure fuller access to those goods and services rather than simply provide more cash income. In that view, any limit on benefits should be imposed on a program-by-program basis to allow the use of different criteria.

Reducing entitlements to medical assistance raises special concerns. One problem is valuing medical services in dollar terms. One approach would base value on benefits actually received. That approach could yield unacceptable results because it would assign the highest values to the sickest people receiving the most care. Another approach would count the federal subsidy to in-kind programs as benefits. In Medicare, for example, the subsidy would be the implicit value of an insurance premium paid for by the government.

Means-testing benefits also poses a transitional problem, particularly for retirees. Recipients of benefits may have made financial decisions and plans expecting particular incomes from entitlements. Changing those benefits could impose hardships. Phasing in taxation of benefits or means tests over time would mitigate that difficulty.

Make All Entitlements Subject to Individual Income Tax. Under current law, some benefits of federal entitlement programs, such as unemployment compensation and military pensions, are fully subject to individual income taxes; others, such as Social Security, are partially so; and still others, such as Medicare and food stamps, are entirely excluded from taxable income. One approach to means-testing all entitlements would include in taxable income all federal entitlement benefits in excess of contributions made for specific programs. Thus, for example, the insurance value of Medicare in excess of premiums paid for Supplementary Medical Insurance coverage would become part of a recipient's taxable income. Program administrators would tell recipients annually the net value of benefits to report as taxable income, using a form 1099-G similar to the forms used to report dividend and interest income. Such inclusion for all entitlements would increase revenues by about $23 billion in 1998 and about $325 billion from 1998 through 2002.

Taxing entitlements recognizes that they increase a recipient's ability to pay taxes in the same way that other forms of income do. Excluding some entitlement payments from taxable income simply because they come from the government could be viewed as violating

the principle that taxes should be related to ability to pay. A counterargument, however, asserts that entitlements are not taxable now simply because benefit levels are set to be net of taxes. If those levels are too high, the Congress should reduce them within each individual program. Making benefits taxable has the advantage of providing a straightforward annual measure of recipients' needs for federal assistance. Even so, it could be difficult to justify including noncash benefits received from the government but not those provided by employers. That last objection is not an issue, however, if taxing benefits is viewed as a means of allocating scarce government resources to the most needy recipients.

Reduce Benefits Provided to Middle- and High-Income Families. The Concord Coalition has proposed that federal entitlement benefits be reduced rapidly as income rises. Benefit reduction could be achieved either through supernormal tax rates imposed under the individual income tax or directly through new programmatic structures. Under the Concord Coalition's proposal, families with income above $40,000 would lose benefits under a graduated scale beginning at 10 percent for those with income between $40,000 and $50,000 and increasing by 10 percentage points for each $10,000 of income up to 85 percent of benefits above $120,000 of total income. Nontransfer income would be considered first in determining the rate of benefit reduction, and benefits would be reduced only to the extent that they caused total income to exceed $40,000. For example, a family receiving $15,000 of Social Security and $30,000 of nontransfer income would lose $500 of benefits--10 percent of the $5,000 by which total income exceeds $40,000. If the family had $45,000 of nontransfer income, it would lose $2,500 of its Social Security--10 percent of the $5,000 that falls in the $40,000 to $50,000 income range and 20 percent of the $10,000 that falls in the $50,000 to $60,000 income range. A family with nontransfer income above $120,000 would have its benefits reduced by 85 percent. (Under the coalition's plan, married couples and larger families would face the same income limits as single people, and all dollar values would be indexed for inflation.)

This option would reduce benefits for all entitlements by about $12 billion in 1998 and $250 billion from 1998 through 2002. Compared with the option that would tax benefits, this proposal to reduce benefits would have no effect on families with lower income and a greater effect on families with higher income.

This approach reflects the view that entitlements should go primarily to those most in need of them, not to families with higher income. Imposing the same criteria for establishing need among all entitlement programs might be the fairest way to limit benefit payments. A global approach to benefit reduction could also be less costly to administer than an approach that addresses each program individually, although whether it would in fact cost less depends in large part on whether new administrative apparatuses would have to be created.

A significant problem with this option is the disincentive for families to save and earn other income that is created by the rapid reduction in benefits as income rises. That effect would be mitigated somewhat, however, if the benefit reduction was phased in gradually over a wide income range. Recipients with income well above the $120,000 level at which benefit reduction was greatest would face smaller or no disincentives, since they would have to lower their income greatly to incur a smaller benefit reduction. They would instead have some incentive to earn more if they wished to maintain the same level of total income. An alternative to forgoing income to lessen benefit reductions would be to shift income to sources that would not be counted in the benefit reduction formula. For example, if interest on tax-exempt bonds was not counted, entitlement recipients would be expected to shift their investments into those bonds. Such behavior could be limited, however, by counting as many forms of income as possible in determining benefit reductions.

Deny Entitlements to High-Income Recipients. Some Members of Congress have proposed a third approach to means-testing entitlements that would deny completely any entitlement payments to recipients with income above specific limits. The budgetary savings shown assume limits of $100,000 for single recipients and $120,000 for married couples, with benefits phasing out over a $10,000 income range. This option would reduce spending on all entitlements by about $5 billion in 1998 and $53 billion over a five-year period. Compared with the proposal of the Concord Coalition to reduce benefits, this option would exempt middle-income families from benefit cuts and impose larger benefit reductions on families with the highest income.

This approach has many of the advantages of and problems faced by the alternative that would simply reduce benefits. Because benefits would be phased out over a narrow income band, however, the work and saving disincentives would be significantly greater for people with income near the cutoff level. Families with more than $10,000 in benefits and income in the phaseout range would face marginal tax rates of more than 100 percent from this provision alone. The narrower the band, the more likely potential recipients with an income in or just above the phaseout range would be to adjust the timing of their income receipts, forgo savings, or reduce work effort to stay under the income limit. At the same time, because beneficiaries with an income below the phaseout range would continue to receive full benefits, many fewer recipients would face work and saving disincentives than in the approach that would reduce benefits over a broad income range. Any reduction in work effort or savings would reduce the budgetary savings. Finally, this approach would also create incentives to shift income to sources excluded from the income calculation.

ENT-46 CHARGE FEDERAL EMPLOYEES COMMERCIAL RATES FOR PARKING

Savings from Current-Law Spending	Annual Savings (Millions of dollars)					Five-Year Cumulative Total
	1998	1999	2000	2001	2002	
Budget Authority	110	115	120	120	125	590
Outlays	110	115	120	120	125	590

The federal government leases and owns more than 200,000 parking spaces, which it allocates to its employees--in most cases without charge. Requiring employees of the federal government to pay commercial rates for their parking could reduce the deficit by $590 million through 2002.

The vast majority of federal workers park without charge. For example, one survey of 10 agencies in Washington, D.C., found that 71 percent of federal workers who received parking from their agencies received it free of charge. Employees of the Congress also received free employer-provided parking. Federal workers who pay for parking are almost always charged less than the commercial rate, although federal agencies, with the approval of the General Services Administration, are allowed to charge their employees the higher commercial fees. Some Members of Congress support charging all federal employees parking fees set at commercial rates, an idea similar to a proposal made by President Carter. The Clinton Administration has also proposed greater incentives for agencies to charge higher rates for parking spaces.

Federal workers in the largest metropolitan areas would bear the brunt of the new charges. Those in the Washington, D.C., metropolitan area would be affected most, paying about 75 percent of the total charges. Federal employees in less commercially developed areas--where charging for parking is uncommon--would not face new fees. The estimated savings rely on information available about the number of federal parking spaces, commercial parking rates, and expected declines in the demand for parking by federal workers as a result of higher rates. Once commercial rates were instituted, however, it would be difficult to predict variations in parking rates, the number of spaces controlled by the federal government, and responses of federal workers.

In 1992, the Congress passed an energy policy law that contained a provision including as taxable income the commercial value of any parking provided free of charge by an employer--including the federal government--in excess of $155 per month (indexed for inflation beyond 1993). Paying for parking at commercial rates would reduce the gross income of such employees; however, the estimate of savings from this option does not include the reduction in tax revenues that would result, because available data do not allow an estimate of the option's effect on revenues. Analysts agree, however, that the offsetting reduction in revenues would be relatively small.

Proponents of charging commercial rates for employer-provided parking argue that subsidized parking increases the frequency with which workers drive to work, especially in single-occupancy vehicles. Those observers believe that higher prices for parking would decrease the flow of cars into urban areas by encouraging the use of public transportation or car pooling. In turn, they argue, a reduction in the number of cars would reduce energy consumption, air pollution, and congestion.

Some supporters of charging fees also maintain that the federal government would be acting as a model employer and could call more effectively on others to reduce pollution and energy consumption. In addition, charging commercial prices for parking would show more accurately the demand for parking by federal workers. At commercial rates, the supply of employer-

provided parking may well exceed demand, which could lead to alternative uses of current parking space. Moreover, commercial pricing would allocate spaces to those who valued them the most, thereby setting aside differences in income. Finally, some observers argue that the federal government can no longer afford to provide valuable goods and services free of charge to workers who can afford to pay for them.

Opponents of full-cost pricing for parking argue that it would unfairly penalize workers in urban areas who have difficulty obtaining access to alternative transportation or who drive to work for valid personal reasons. In the view of those critics, charging commercial rates for parking for federal workers effectively represents a cut in total compensation and is inappropriate, given other proposed reductions in federal employment and compensation. Some critics have also argued that free parking is a common form of compensation in the private sector. (However, in the Washington, D.C., metropolitan area, only 37 percent of parking spaces for private-sector workers were provided free of charge in 1991; 46 percent were priced at full commercial rates.) In addition, some people argue that the new charge will simply change the mix of federal employees using the parking spaces--higher-income employees will be favored over lower-income ones. Now, the allocation of parking spaces in many agencies is based on rank, seniority, or other factors; instituting fees for parking would ration spaces to employees who were willing to pay commercial rates.

If the funds collected from charging commercial rates for parking were used to finance other spending, the savings noted earlier in this option would be smaller or zero. The Administration, for example, has supported new incentives for agencies to charge higher rates for parking in order to subsidize the use of mass transit by their workers. That proposal would neither reduce nor enlarge the deficit because agencies would not rebate the fees to the Treasury but instead provide them to transit-using employees. The funds raised by this option would be counted as offsetting collections or offsetting receipts, depending on how the option was applied.

ENT-47 MAKE PERMANENT VARIOUS EXPIRING USER FEES INCLUDED IN THE OMNIBUS BUDGET RECONCILIATION ACTS OF 1990 AND 1993

Addition to Current-Law Receipts	Annual Added Receipts (Millions of dollars)					Five-Year Cumulative Total
	1998	1999	2000	2001	2002	
Patent and Trademark Fees	0	119	119	119	119	476
Vessel Tonnage Charges	0	49	49	49	49	196
Rail Safety Fees	45	45	45	45	45	225

The Omnibus Budget Reconciliation Acts of 1990 and 1993 (OBRA-90 and OBRA-93) created user fees for a variety of services that the federal government provides to private parties. OBRA-90 enacted rail safety fees for 1991 through 1995. OBRA-93 levied fees on vessel tonnage and imposed patent and trademark fees that will expire in 1998. Extending those fees could raise $897 million in receipts for 1998 through 2002, providing offsetting receipts in the budget functions designated for commerce and transportation.

The general argument for user fees applies to each of the proposals included in this option; namely, that the recipients of government services should bear the cost of those that clearly benefit a specific group. Accordingly, patent and trademark fees are established to cover the cost of providing services to would-be holders of a patent or trademark. The vessel tonnage fee is collected on all vessels entering a U.S. port and helps support the general operations of the Coast Guard. The fees charged to railways offset the cost of the government's railway safety activity.

Antithetically, it can be argued that services provided by the government ultimately benefit the general populace and should be paid for by all taxpayers rather than a specific group. Those who advocate the repeal of specific fees argue that charges were unevenly applied among users or, directly or indirectly, inflicted undue costs on payers.